

# FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR 2015

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## HEARINGS BEFORE A SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS HOUSE OF REPRESENTATIVES ONE HUNDRED THIRTEENTH CONGRESS SECOND SESSION

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# **FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR 2015**

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WEDNESDAY, FEBRUARY 26, 2014.

## **OVERSIGHT HEARING: INTERNAL REVENUE SERVICE**

### **WITNESSES**

**HON. JOHN KOSKINEN, COMMISSIONER**

**HON. J. RUSSELL GEORGE, TREASURY INSPECTOR GENERAL FOR TAX  
ADMINISTRATION**

**NINA E. OLSON, NATIONAL TAXPAYER ADVOCATE**

Mr. CRENSHAW. The hearing will come to order.

This is the first hearing of the year for our subcommittee. Welcome to all our returning subcommittee members. Glad to have you back. A warm welcome to our subcommittee's newest member, Mr. Amodei, who is not here yet. He is down at the end. But we look forward to having him work with us.

Today, the subcommittee is going to hear from two panels. We are going to hear about the activities and the operations of the Internal Revenue Service. Our witness for the first panel is IRS Commissioner John Koskinen.

Welcome to you, sir. We appreciate your return to Federal service, and we thank you for taking on this responsibility, which I think we would all agree is a difficult time.

Our second panel of witnesses are Treasury Inspector General for Tax Administration Russell George and National Taxpayer Advocate Nina Olson. Mr. George is a regular witness for the subcommittee, and we appreciate his careful and constant oversight of the IRS. We have not heard in some time from Ms. Olson, so we are especially eager to hear from her.

Now, as a matter of housekeeping, I am going to be following the 5-minute rule for the Members. I don't plan on cutting anybody off in the middle of their sentence, but if everybody could keep their questions and comments when we get to that part of the hearing to 5 minutes, that will give us a chance to hear from everybody and have maybe more than one round of questions.

I am going to recognize the Members in order of seniority for those that were here when the gavel went down. For the latecomers, we will recognize them based on their arrival. And we will go back and forth between the parties.

Now, I think most of you know that the 2014 appropriations cycle tested our endurance. It was only after the fiscal year had started and after we had a government shutdown that the Budget Committees came to an agreement on the discretionary spending. And once we had that agreement enacted, we rolled up our sleeves,

we went to work very quickly, and got a bipartisan omnibus appropriations bill enacted, thanks in no small part to our distinguished Chairman, Mr. Rogers, who is here with us today.

So we hope that this year it is going to go a little more smoothly because we already have an agreement on the total discretionary spending that is in place, and so we can have regular order. And by that, I mean the way we are supposed to work and that we will mark up our bills, we will subject them to amendments at the full committee and on the House floor, and then we will conference them with the Senate.

Now, the Administration hasn't submitted their budget for 2015 yet, but we will have that soon. We have invited the Commissioner to come back probably in April to talk about how much money, his wants and his needs. Today, this is an oversight hearing. And that really gets into how do you spend the money that you have been appropriated? The "how much" will come a little bit later. But I would suggest that the two are very interrelated because how you spend the money that you have impacts how much money you will receive in the future.

I think that we all know that you have come to the IRS in what would be described as a difficult time. Some would say you have inherited a pretty big mess. We have had a situation, I would say it is one of the dark periods in the IRS history. You had at a time when the IRS was awash with money, their horseplay harassment started, lavish conferences were held, millions of dollars were wasted, silly videos were made, and that was not good for anybody. At the same time, we found out the IRS was singling out individuals, groups of individuals, subjecting them to harassment, to intimidation, bullying, if you will, in an effort, it seemed, to shut down their involvement in politics. And that is what you inherited, and also probably inherited an agency that wasn't doing a very good job of dealing with the customer, the folks that call the IRS and have questions.

And so, when your predecessor was sitting in the chair you are sitting in, I asked him at a hearing like this, do you think the IRS has betrayed the trust of the American people? And he said, yes. He said, but I want to try to help rebuild that trust. And I am sure that one of your goals as the new guy, as the new Commissioner, is to rebuild the trust that has been lost with not only in some part with this committee, but also the American people. And that is what you are about.

And I must tell you that some of the decisions that you have made early on are of some concern to me as you try to rebuild that trust—for instance, \$63 million of bonuses that were paid. Reversing a decision that your predecessor made to not pay those bonuses is troublesome.

I know that you didn't begin this 501(c)(4) rulemaking process. There is a rule that has been proposed that some would say puts in rule form what the problem was with the IRS harassing people and trying to cut off their political involvement. And the same people that were using the Tax Code to try to quiet people's political involvement are now proposing a rule that some would argue does the same thing and infringes upon their First Amendment right.

And you didn't start the process, but you are continuing the process.

One of the things that I have read from time to time—I know you were in my community; you were kind of on a whirlwind tour to talk to all the different IRS offices. One of your constant messages seems to be that we don't have enough money to do the things that we need to do. And one of the things that I read about from time to time is the fact that you can't answer all the phone calls, that I think it is 61 percent of the phone calls are probably going to be answered. I have heard you say, if we had more money, we could hire more people, we could answer more phone calls. And I know in Jacksonville, my hometown, when you were there, there was an article in the paper that said that you had said we don't have enough money to answer more than 61 percent of the calls and you found that, I think, unacceptable or intolerable or outrageous or something.

But I must tell you that what I find unacceptable is that in this \$11.3 billion appropriation that the IRS received this year that you can't find the money to answer more than half the phone calls and yet you can find the money to pay \$63 million in bonuses. And it seems to me that that might be a slap in the face to the taxpayers, because their customer services, as they try to find answers from the IRS, they are going to find that that is going down, and yet the salary and bonuses of the employees are going up. And I would think that is hard to tolerate as a taxpayer or as an individual saying, I would like better customer services.

It bothers me to see that you don't have enough money to answer those phone calls but you have the money and the time and the energy to pursue this rule. I read today, I think there are nearly 100,000 comments on this rule. And the XL pipeline, which is pretty controversial, there may be 7,000 comments. So here is a rule that is wildly controversial and has to be taking some time and energy and money, but you continue to pursue that, or whoever started it continues to pursue it, and yet there is not enough money to answer the phone.

And then I know that we hear from time to time the argument, well, if you just give the IRS more money, then they will collect more revenue. In fact, the argument is that if you give the IRS \$1, then you will get back \$4 or \$5—

Mr. SERRANO. Six.

Mr. CRENSHAW [continuing]. Maybe \$6, in revenue, and if you don't give the IRS money, then the revenues will go down and the deficit will go up.

Well, it makes intuitive sense to say, if you give the IRS more money, they can collect more revenue. It sounds like it makes sense. But there is no empirical evidence that that is true. In fact, at times, just the opposite is true. In 2001–2009, the appropriations was increased for the IRS and the revenue collections went down.

So, obviously, there are other factors than just how much money the IRS got. You have to look at inflation, you have to look at population, you have to look at tax policy, you have to look at a lot of different factors. In fact, last year, 2013, that is the best year ever. We collected \$2.8 trillion, the most money the United States of

America has ever collected, and that is at a time when the sequester was going on and so there was less money for the IRS to have.

So all of that is to say, I don't necessarily believe that a higher level of spending equals a higher level of service. And that is why I think we are holding an oversight hearing to see how are you spending the money. Because it is not just how much you have, but how you spend it.

I think how you spend it can actually improve even if you don't have as much as you might like to have. Because everybody knows the government needs money to provide services, right? But everybody also knows that these are difficult times in our country. We have \$17 trillion in debt. We have an annual deficit. This year it is going to be less than a trillion dollars, and we are all excited about that. It is the first time in 5 years it has been less than \$1 trillion, but it is still probably the fourth- or fifth-largest deficit we have ever had on an annual basis.

So, yes, the government needs money, but I would say today government needs something more than that. It needs discipline to rein in spending. It needs courage to make tough decisions. It needs the commitment to make sure that we do everything more efficiently and more effectively than we have done it before.

And we want to work with you to help you do that, to help you set the right priorities, to help you spend the money that we appropriate to you. And so we thank you for being here today. We will have questions, I know.

And before we do that, I want to turn to my friend, the Ranking Member, Mr. Serrano. And first let me say to him, because it has been a whirlwind time when we finished the omnibus bill, but he has been a great partner. We don't always agree on everything, but as we went through the final negotiations with our Senate counterparts to come to this conclusion, it was a team effort. And I want to thank him for that and ask him for any comments he might have.

Mr. SERRANO. Thank you, Mr. Chairman. And I want to thank you for your willingness to work with us, and especially your staff and our staff. They did a great job under a lot of pressure.

And let's hope that the last omnibus puts us back on the road to regular order, something that Chairman Rogers and I love and you love, something that some of the younger, newer Members on the Committee and Congress may not have ever witnessed—you know, the days when we could pass a bill with 400 votes and actually predict what the final count would be, 350 or 400. Those days are long gone, but they may come back based on what we saw.

I would also like to welcome the new Internal Revenue Service Commissioner, John Koskinen, for his first hearing before the Subcommittee. I thank you for your service to our Nation and for undertaking this endeavor at a very challenging time for the IRS.

By now, most Americans know that last year it was reported that the IRS had used inappropriate criteria to decide what 501(c)(4) entities should be subject to greater scrutiny. As I said at the time, all Members of Congress were appalled by these actions, which affected liberal and conservative groups alike. We all believe that the IRS must enforce our tax laws in a fair, evenhanded manner, and that did not occur here.

At a hearing soon after the controversy came to light, the question I asked was, where do we go from here? What must be done to prevent something like this from happening again?

I think that the IRS has made a good start at answering those questions. The IRS has implemented all of the recommendations suggested by the Treasury Inspector General for Tax Administration in this area. The IRS has also implemented numerous internal reforms that have brought more accountability and oversight to the review decisions that are being made. And perhaps most importantly, the IRS is making an effort to further clarify for 501(c)(4) organizations what is and what is not political activity.

There is no doubt that in recent years a number of groups have abused their claims to 501(c)(4) tax-exempt status by primarily engaging in political activities. This tax-advantaged status is not a right but, rather, a responsibility, and too many organizations have been claiming it as a way to avoid transparency and taxes.

Last year, I suggested that the IRS needed to revisit these rules to provide greater clarity to organizations and to their own auditors as to what is considered a political activity for purposes of making a 501(c)(4) designation. The rules proposed late last year by the IRS have attempted to do just that, in my opinion. I cannot say whether the IRS has struck the exact balance necessary in these proposed rules, but I do know that they will take any and all concerns seriously before finalizing them.

However, this Committee cannot help the IRS in these reforms if we do not adequately fund the Agency. The fiscal year 2014 appropriations act gave the IRS \$92 million more than the sequester level, but the IRS is still being funded at its lowest level since fiscal year 2008.

If we care about the fair implementation of our tax laws, then this is simply unacceptable. We all know that at this level of funding every additional dollar given to the IRS allows them to bring in at least \$6 from tax cheats. We cannot keep asking more and more of the IRS while providing them with less and less. That is not a good recipe for tax compliance or for this Nation.

I hope this hearing will be of use to members of this Subcommittee as we discuss funding levels for the IRS in the fiscal year 2015 appropriations process, but I am concerned that we might be here to just engage in election-year politics. So let me simply state the facts that are on the record already, and these are facts that have already been proven after significant congressional investigation.

Yes, the inappropriate targeting affected both liberal and conservative groups alike, not just one side. No, this targeting was not orchestrated by any political appointee or by any individual outside the IRS. And, yes, the IRS has been forthcoming in helping numerous investigations by using more than 150 employees to engage in 70,000 hours of work to provide the various investigations with more than 500,000 pages of documents.

These are issues that simply do not need to be rehashed at this point again. Rather, this hearing must look forward. The fiscal year 2015 appropriations process is upon us, and the focus of this committee needs to be on ensuring that proper reforms are in place and that the IRS has the resources to complete its mission of serv-

ing the American taxpayer and ensuring that everyone follows the law. We all know the importance the IRS has in ensuring that we have the funding to pay for everything from national defense to Head Start. Using this controversy to cut further resources from the agency will not just harm the IRS but the American people as well.

Commissioner, once again, welcome to the subcommittee, and I hope that when we meet again in April it will be under better circumstances.

Thank you.

Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you, Mr. Serrano.

And now I would like to turn to the chairman of the full committee, who has joined us, Mr. Rogers, for any opening statement he might have.

Mr. ROGERS. Thank you, Chairman Crenshaw, for yielding me this time.

Thank you, Commissioner Koskinen, for being with the Committee for its first hearing of this year. This is the very first of what will be probably 100 to 120 hearings our Committee will conduct during the course of this spring season. You are the very first one, so you have the privilege and honor of sitting in the dunk tank for the first time, the first one there.

Before we get to the important business at hand today, let me first echo the Chairman's sentiments regarding the appropriations process in general terms. The omnibus bill for fiscal 2014 that we all worked on to pass last month is a true product of compromise. I value my partnership with Ranking Member Lowey, her counterpart on the Senate side, Chairwoman Mikulski, as well as Ranking Member Shelby. Together, along with the subcommittee Chairs and Ranking Members, we made responsible choices to realign our Nation's funding priorities and target precious tax dollars where they are needed the most, all the while continuing the 4-year trend of reducing Federal discretionary spending.

While the 2014 omnibus is certainly a testament to this Committee's longstanding tradition and practice of bipartisan workmanship, now is not the time to rest on our laurels. As Chairman Crenshaw has mentioned, I expect the Committee to move forward under regular order to draft legislation for Federal spending in 2015 that continues to right-size our Federal Government, that prioritizes spending on programs that are demonstrating results, and that is a product of thoughtful, rigorous oversight. We have much difficult work ahead of us, but I am hopeful that the process will move swiftly and smoothly, given the Ryan-Murray budget agreement.

I think it is fitting that this commitment to regular order and transparency in the appropriations process is reaffirmed at today's hearing with the IRS. Just as the Congress has a supreme responsibility in stewardship of the taxpayer dollar, so, too, does the IRS have that special duty to apply our country's tax laws fairly and uniformly.

Commissioner Koskinen, you have taken the helm of this agency during a tumultuous time, to say the least, as I fear that in recent years there have been grave violations of the public's trust that



should give all Americans cause for concern. And I hope that you are the right person to right the ship.

In particular, as I wrote to you earlier this month, I have serious concerns about the proposed regulation published by your predecessor in November. This rule would continue to target the First Amendment rights of the same conservative grassroots organizations that were unfairly scrutinized in applying for tax-exempt status in the run-up to the 2010-2012 elections.

Given the agency's recent track record of improper politicization and intimidation, I strongly believe this rule is a step in the wrong direction for an agency struggling to regain the American public's faith and confidence. I look forward to hearing from you about your intentions in this respect today—in particular, your plans to cooperate with the Congress to ensure these dark days in the IRS history books are truly behind us.

Acting Commissioner Werfel last came before the committee on the heels of a report detailing the IRS's wasteful spending on frivolous conferences and the revelation that the senior executives who oversaw the 501(c)(4) debacle in Cincinnati had received significant performance bonuses.

Listening to Chairman Crenshaw's remarks feels like *deja vu* all over again. As the IRS is charged with the massive undertaking of enforcing the individual mandate of the Affordable Care Act, the greatest intrusion of this agency into personal healthcare decisions in history, combating identity theft and refund fraud, and addressing international compliance issues, among many other competing priorities, you can understand why the Committee views your proposal for additional performance awards and more training conferences with heightened scrutiny.

We hope to ascertain how the IRS will go about planning its training conferences to ensure that they are goal-oriented and effective as well as compliant with the IRS's procurement processes. Also, if you can explain to the satisfaction of this Committee how and why \$63 million in performance bonuses are appropriate or beneficial to the taxpayer. As we are all painfully aware, we are in the middle of some grim budget times, and every Federal agency, especially the IRS, is duty-bound to rout out excess and waste. When we provide you with more than \$11 billion annually to fulfill these duties, we expect you to spend it wisely and effectively.

And, Mr. Commissioner, I hope that we have your commitment to work with this Committee to achieve our shared mission of protecting the taxpayers and their hard-earned dollars. We look forward to hearing your testimony, and we wish you the best of luck.

Mr. KOSKINEN. Thank you.

Mr. CRENSHAW. Thank you, Mr. Rogers.

[The information follows:]

The decision to pay performance awards in today's tight budget environment was not made lightly. Following my recent visits with frontline employees and managers, I have observed first-hand their hard work and accomplishments. Additionally, the National Treasury Employees Union (NTEU) had filed a grievance. The settlement agreement we reached allowed us to resolve the grievance and unfair labor practice charges, which could have resulted in the payment of a full 1.75 percent of total annual bargaining unit salaries (approximately \$76 million) as well as attorneys' fees and interest. I am convinced reinstating these awards in FY 2014 was the correct decision. Providing these awards avoided protracted litigation and allowed us to recognize our high-performing employees who do impressive work in a wide range of areas across the IRS, from taxpayer service and tax enforcement to Information Technology and other critical support functions. I decided these awards, which we funded from reduced labor costs resulting from a FY 2011 hiring freeze implemented, were a wise investment in the workforce.

We have internal controls to ensure employee awards are used appropriately. These controls include:

- Performance awards must be exclusively based on official performance ratings documenting employee accomplishments against written performance standards.
- Non-supervisory, non-bargaining unit employees' performance awards require approval at least two management levels above the employee proposed for award.
- Non-executive supervisory employees' performance awards require approval from performance review boards. The board for each payband is comprised of executives, senior managers, department managers and frontline managers dependent on the level the board is reviewing. For example, the Senior Manager Review Board would be comprised of executives and possibly other senior managers, while the Frontline Manager Review Board would be comprised of executives and possibly senior managers, department managers, and other frontline managers. Once approved by the board, performance bonuses are elevated to the business unit's head of office for final approval.

FY 2014 overall award funding for supervisory and non-bargaining unit employees is currently limited to approximately .96 percent of salaries. Funding for bargaining unit employees is limited to 1 percent of salaries which is less than the 1.75 percent rate of previous awards. Funding for executives was limited to 4.5 percent of salaries.

Mr. CRENSHAW. And now we will turn to the Commissioner for his testimony.

If I could ask you, if you have any written remarks you would like to submit, but if you could keep your oral testimony in the neighborhood of 5 minutes, it will give us more time to ask questions.

So the floor is yours.

Mr. KOSKINEN. Thank you, Chairman Crenshaw, Ranking Member Serrano, and members of the Subcommittee, and the committee chairman Congressman Rogers. Thank you for the opportunity to appear before Congressman Rogers.

Mr. CRENSHAW. Turn on your mike.

Mr. KOSKINEN. That would also help.

Mr. Chairman, Ranking Member Serrano, Chairman Rogers, and members of the subcommittee, thank you for the opportunity to appear before you today to give you an overview of IRS operations.

I am honored to serve as the IRS Commissioner, and to have the opportunity to lead this Agency and the dedicated employees because I believe the success of the IRS is vital for this country. I want to outline for you what I believe are the IRS's key challenges and what I will focus on, moving forward.

First and foremost, we just started a new filing season 4 weeks ago, and over 39 million returns have already been filed. We sometimes lose sight of what a tremendous accomplishment it is for the Agency to process efficiently 150 million individual taxpayer returns, with 120 million of those being filed electronically. I am confident that, thanks to the hard work of our employees, the filing season will continue to go well.

Another priority for our Agency is to put to rest all of the issues and concerns surrounding applications for tax-exempt status. The management problems associated with the 501(c)(4) application process have, as noted, shaken public trust in the IRS. Under the leadership of former Acting Commissioner Danny Werfel, the IRS has already made great progress in this area, and it is my job to help make sure we complete that work. In every area of the IRS, taxpayers need to be confident they will be treated fairly, no matter what their background or their affiliations. Public trust is the IRS's most valuable asset.

The IRS also needs to build on the progress that has been made to improve tax compliance in a number of areas. One of the most critical of these is refund fraud caused by identity theft. The IRS has gotten much better at resolving identity-theft cases. We closed 963,000 cases last year of individuals who had had their identity stolen, which is almost double the number for 2012. And we are resolving those cases for taxpayers much faster. On average, it now takes about 120 to 135 days to resolve new cases, compared to more than 300 days in prior years. But we can and will do better.

Along with enforcement, the IRS also needs to keep looking for ways to improve the service we provide to taxpayers, which is critical to ensuring that our system of voluntary compliance works properly.

I am deeply concerned, as the Chairman noted, about the significant reduction in the IRS budget over the last years. Our current funding level, at just under \$11.3 billion, is roughly \$900 million

below what it was 4 years ago. We now have about 10,000 fewer employees than 4 years ago, including 3,500 fewer Revenue Agents and Officers.

As a result of fewer staff and reduced enforcement activities, the IRS estimates it will not be able to collect billions of dollars in enforcement revenues. In fiscal year 2014, we expect audits conducted by the IRS will decline by an estimated 100,000 and the number of collection activities will decline by an estimated 190,000.

One of our biggest concerns is being able to deliver the services taxpayers need during the filing season. Last year, as noted, for example, almost 40 percent of taxpayers who called were unable to reach an IRS employee, and, as the Chairman noted, that is unacceptable. Our employees are doing their best to answer every call they can, and our level-of-service goal during the filing season is 70 percent. For the full year, however, we estimate 18 million taxpayer calls will not be able to reach us.

Another area of concern is the amount of time people are having to wait to get in-person help at our Taxpayer Assistance Centers. We have had reports from field staff of taxpayers lining up outside those centers well before they open in the morning to make sure they receive service the same day. The best of employee efforts and expansion of our online offerings can only go so far to ameliorate those problems.

Amid our budget difficulties, I do recognize that there has been a loss of confidence within Congress and this Committee in regard to the way the IRS has managed its operations. One of my responsibilities is to ensure that we quickly solve management and operational problems that may arise so that Congress and this Subcommittee can be confident our funding will always be used wisely, that we understand the need to be careful stewards of taxpayer dollars entrusted to us.

I look forward to working with Congress and this Subcommittee to solve our budget problems. I hope that one of my legacies at the end of my 4 years as IRS Commissioner will be that we have put the Agency on a more solid and sustainable funding level.

This concludes my statement, and I would be happy to take your questions.

Mr. CRENSHAW. Well, thank you very much.

[The information follows:]

**WRITTEN TESTIMONY OF  
JOHN A. KOSKINEN  
COMMISSIONER  
INTERNAL REVENUE SERVICE  
BEFORE THE  
HOUSE APPROPRIATIONS COMMITTEE  
SUBCOMMITTEE ON FINANCIAL SERVICES AND GENERAL GOVERNMENT  
ON THE STATE OF THE IRS  
FEBRUARY 26, 2014**

**I. INTRODUCTION**

Chairman Crenshaw, Ranking Member Serrano and Members of the Subcommittee, thank you for the opportunity to appear before you today to give you an overview of IRS operations.

I am honored to serve as IRS Commissioner and to have the opportunity to lead this agency and its dedicated employees, because I believe that the success of the IRS is vital for this country. The agency collects about \$2.9 trillion each year, which is more than 90 percent of the revenue collected by the federal government. The activities of the IRS touch virtually every American. This is a challenging time for the agency, as it must continue to fulfill its dual mission of tax compliance and taxpayer service while dealing with substantial budget reductions as well as the management problems that came to light last year.

I want to begin by outlining for you what I believe are the IRS' key challenges and what I will focus on going forward. First and foremost, we have recently started a new filing season, and our employees have spent the last several months in planning and preparation to ensure that it goes smoothly, not only to ensure proper revenue collection but also to ensure that taxpayers can fulfill their tax obligations as quickly and easily as possible.

It will also be critical to build upon the important work being done to improve tax compliance in a number of areas, including reducing refund fraud caused by identity theft. Enforcing the tax laws is vital to preserving our system of voluntary compliance. The vast majority of taxpayers are law abiding, and they must always feel confident that the system is fair, and that everyone is required to play by the rules. Along with enforcement, we must continue to improve taxpayer service, which is critical to ensuring that our system of voluntary compliance works properly. The IRS also must continue to fulfill our responsibilities to implement tax-related provisions of major legislation that Congress has enacted, including the Affordable Care Act (ACA) and the Foreign Account Tax Compliance Act (FATCA).

Another priority for our agency is to continue to address the issues and concerns surrounding applications for tax-exempt status. The management problems associated with the section 501(c)(4) application process have shaken public trust in the IRS. Under the leadership of former Acting Commissioner Danny Werfel, the IRS made a great deal of important progress in this area, and it is my job to complete the work that he began. Taxpayers need to be confident that the IRS will treat them fairly, no matter what their background or their affiliations. Public trust is the IRS' most important and valuable asset.

On the management side, I strongly believe that the success of the IRS depends on the experience, skills and enthusiasm of our employees, and I intend to do everything I can to make the most of this very valuable resource. Notwithstanding the issues associated with the 501(c)(4) process noted above, I have been very impressed by the experience and professionalism of the IRS employees I have met so far, both here in Washington and in the IRS offices I have visited over the last few weeks. I am also proud to lead an organization that has had a longstanding commitment to ensuring fairness in the workplace, and I believe that diversity and inclusion are equally critical to our mission, our employees and our customers. We cannot strive for anything less than a fully inclusive workplace.

The recent visits I have made to various IRS offices and the meetings I have had with employees reinforce my long-held belief that the people in an organization who know the most about what is going on are the frontline employees. I intend to listen to our employees and make sure they understand that we appreciate their dedication and look forward to benefitting from their insights and suggestions. I have told our employees that I will do everything possible to ensure that they have the leadership, systems and training to support them in their work and allow them to reach their full potential to best serve taxpayers.

In discussing the state of the IRS, no challenge facing our agency is greater than the significant reduction in funding that has occurred over the last several years. Later in this testimony I will outline the important work that our agency has done recently to reduce costs and increase efficiencies. But even with these efforts, which are ongoing, I am deeply concerned about the ability of the IRS to continue to fulfill its mission if the agency lacks adequate funding. Our current level of funding is clearly less than what the agency needs, especially to provide the level of taxpayer services the public has a right to expect. At the same time, we recognize that there has been a loss of confidence within Congress in regard to the way we manage operations. One of my responsibilities is to ensure that we are minimizing risks and quickly solving management and operational problems that may arise, so that Congress can be confident that, when we request additional funding, that money will be used wisely. Taxpayers provide the funds we receive and they deserve to be confident that we are careful stewards of those resources.

We will make every effort to provide the level of service that taxpayers need this filing season, but remain concerned that the level of service will fall short without adequate funding. It is vital that we find a solution to our budget problem, and I look forward to working with Congress to do just that. I hope that one of the legacies of my four years as IRS Commissioner will be that we put the agency's funding on a more solid and sustainable footing.

## **II. STATE OF IRS OPERATIONS**

### **Filing Season**

Each year the IRS works to deliver a smooth and successful filing season. The numbers showing what we undertake can be mind boggling. In Fiscal Year (FY) 2013, the IRS collected about \$2.9 trillion in revenue to fund the federal government, which represents more than 90 percent of all federal receipts. In FY 2013, the IRS processed 147.7 million individual tax returns and issued 109.6 million refunds to taxpayers totaling \$301.9 billion. In addition, IRS employees responded accurately to 95.7 percent of tax law questions and 96.0 percent of taxpayer account questions answered via phone.

The IRS' e-file program continued to grow in FY 2013, with 121.9 million individual returns, or 82.5 percent, filed electronically, an increase of 2.5 percent from the previous year.

Preparing for the 2014 filing season, which opened on January 31, was challenging as a result of the 16-day government shutdown last October – the longest shutdown the IRS has ever experienced. About 90 percent of our operations were closed during this period, with work being stopped, for example, for 3,000 to 4,000 IT staffers, many of whom would have been working to deliver the 2014 filing season.

After a careful review of all of the complex programming and system needs involved, the IRS made the decision to open the filing season on January 31, 2014, 10 days later than the date that was originally scheduled for e-filers to begin filing returns. The later date allowed the agency needed time to program and test its tax processing systems.

Through February 14, 2014, the IRS has received more than 39.2 million individual returns for this filing season and issued more than 31.3 million refunds for approximately \$100.5 billion. The average dollar refund is about \$3,200, and the IRS has directly deposited more than 27.7 million refunds to taxpayers thus far, an 11.2 percent increase over the same period last year.

## **Taxpayer Service**

The IRS provides year-round assistance to taxpayers to help them fulfill their tax obligations. By assisting taxpayers with their questions before they file, we help prevent inadvertent noncompliance, thus reducing burdensome post-filing notices and other correspondence from the IRS.

The taxpayer assistance provided by the IRS comes in many forms, including: outreach and education programs; issuance of tax forms and publications, rulings and regulations; toll-free call centers; in-person help at Taxpayer Assistance Centers (TAC); and our website, IRS.gov.

For FY 2013, as a result of the ongoing decline in agency funding, the telephone level of service for taxpayers trying to reach the IRS' toll-free lines dropped to 60.5 percent, the lowest level since FY 2008. That means that approximately 40 percent of taxpayers who called were unable to reach an IRS employee, a level of service that we find unacceptable. We will do the best that we can during the remainder of this fiscal year, but even with the most energetic response by our employees, that number is not likely to improve by much, if at all, given the current level of funding the IRS receives.

One way to ameliorate, to some extent, the decline in service levels when taxpayers call is to make the information on our website more understandable and provide more web-based tools and services so that taxpayers can securely interact with the IRS just as they would in a live service channel. We continue our efforts to improve and expand the amount of tax information and web services available through IRS.gov. In FY 2013, taxpayers viewed IRS.gov web pages more than 450 million times. These taxpayers used IRS.gov to get forms and publications, find answers to their tax questions, and check the status of their refunds. Taxpayers used the "Where's My Refund?" electronic tracking tool 132 million times in FY 2012 and 250 million times in FY 2013. We expect that number to increase again this filing season.

The IRS also offers a Smartphone application, IRS2Go, that allows taxpayers to check the status of their refund and get tax news updates on their mobile devices. Earlier this month, we released an updated version of IRS2Go with new features for taxpayers to access the latest information to help them in preparing their tax returns. To date, there have been more than 3.5 million downloads of the application since its inception in 2011.

The IRS has also expanded the methods by which it communicates with taxpayers. Moving beyond traditional media, such as newspapers and broadcast news, the IRS continues to employ new technologies and social media, such as YouTube and Twitter, to reach more taxpayers and provide important service and compliance messages to them.



For the 2014 filing season we have several new digital applications that will further improve taxpayers' interaction with the IRS. One of these is IRS Direct Pay, which we introduced as a pilot program in November 2013. IRS Direct Pay provides taxpayers with a secure, free, quick and easy online option for making tax payments. Use of IRS Direct Pay will be more convenient for many taxpayers and should significantly reduce the number of paper checks that we have to process, which now total about 73 million per year.

Another innovation, which we launched in January, is Get Transcript. Get Transcript is a secure online system that allows taxpayers to view and print a record of their IRS account, also known as a transcript, in a matter of minutes. Prior to the introduction of this online tool, taxpayers had to wait five to seven days after placing an order to receive a paper transcript by mail.

We are also in the final stages of revamping the IRS Online Payment Agreement, which allows taxpayers to apply for an installment agreement online. We have streamlined the application process to make it quicker and easier. We expect to launch this improved product this spring.

The IRS' commitment to taxpayer service also means assisting taxpayers who are facing difficult economic times and other hardships in meeting their tax obligations.

One major example of our efforts in this regard is the Fresh Start initiative, which began in 2011. Under this initiative, the IRS has increased the flexibility of its collection program to help taxpayers who are struggling financially. For example, it is now easier for taxpayers to obtain lien withdrawals – that is, for the IRS to withdraw a tax lien notice that it has filed against a taxpayer – after paying back taxes owed. In addition, the IRS now allows liens to be withdrawn when a taxpayer signs a Direct Debit Installment Agreement (DDIA), which is an agreement to have the IRS automatically debit payments from a taxpayer's checking account for the agreed-upon installment amount. Another provision helps more small businesses get access to Installment Agreements if they sign up for a DDIA and have less than \$25,000 in unpaid taxes. The rules were also changed for Offers in Compromise (OIC) so that more taxpayers could qualify for a streamlined OIC. With streamlining, the IRS has more flexibility when analyzing a taxpayer's ability to pay, can make fewer requests for additional financial information or, if the information is needed, take it over the phone rather than requiring a submission by mail.

We also assisted taxpayers who are victims of crises such as natural disasters. In 2012 and 2013, the IRS moved quickly to provide tax and filing relief to victims of wildfires and tornadoes in Oklahoma, and storms and flooding in Alabama, Alaska, Colorado, Florida, Illinois, Indiana, Kentucky, Tennessee, and West Virginia. In addition, the IRS provided tax and filing relief to victims of Hurricane

Isaac in Mississippi and Louisiana, and to victims of Hurricane Sandy in Connecticut, Maryland, New Jersey, New York, and Rhode Island.

Along with natural disasters, last year the IRS provided tax filing and payment extensions to taxpayers in and around Suffolk County, Massachusetts -- which includes the city of Boston -- who were affected by the tragedy that occurred during the Boston Marathon on April 15, 2013.

## **Enforcement**

Enforcement of the tax laws is a critical component of the U.S. tax system. The IRS strives to carry out a rigorous enforcement program, which includes: a balanced examination program to help ensure that taxpayers accurately report their income, deductions and credits; an effective collections program to collect assessed tax liabilities; and efforts to detect and stop non-compliance, fraudulent schemes, and tax crimes.

Taken together, the IRS' enforcement activities collected approximately \$53.3 billion in taxes and penalties in FY 2013, an increase of \$3.1 billion from FY 2012. Most of the increase came from a \$2.6 billion rise in revenue from cases under review at Appeals, which generally relate to examinations for much earlier years. Revenue from our Collection function, the levels of which also frequently rise and fall in tandem with the overall health of the economy, increased by nearly \$1 billion in FY 2013.

While we are pleased with the overall increase in receipts from enforcement in 2013 compared to the prior year, the total is still down by more than \$4.2 billion from four years ago, and we are concerned about the steady decline since the high point of \$59.2 billion in FY 2007. The reason for this decline is primarily due to a decline in revenue from audits, which dropped nearly \$400 million in FY 2013 to \$9.83 billion, the lowest level in a decade. This decline in audit revenue mirrors a decline in the number of returns audited. The IRS audited the returns of approximately 1.4 million individuals in FY 2013, down 5 percent from FY 2012 and the lowest level since FY 2008 when there were 1.39 million audits. The audit coverage rate -- the number of audits divided by the number of tax returns -- fell below 1 percent to 0.96 percent in FY 2013, the lowest level since FY 2006. Audits of high-income individuals -- defined as those with \$1 million or more in income -- fell 3.7 percent last year. The IRS examined approximately 61,000 business returns in FY 2013, down 13 percent from FY 2012.

The decline in individual and business audits coincided with a decrease in key enforcement staffing personnel in three major categories in FY 2013. There were 1,300 fewer enforcement personnel overall -- including those responsible for exams, collection and investigations -- than in FY 2012, a drop of 6.4 percent, and the lowest number in a decade. The decrease is even more pronounced

when compared with the numbers for FY 2010 when we had over 3,100 more enforcement personnel than we had in FY 2013 in these key categories.

The IRS has made progress in the Criminal Investigation (CI) area, where prosecutions recommended by IRS CI increased to 4,364 in FY 2013 from 3,701 the previous year. This is the highest level of prosecution recommendations in more than a decade. The conviction rate for cases tried in court reached 93.1 percent, also the highest in a decade. Other key Criminal Investigation measures, such as the number of investigations initiated, also increased in FY 2013.

The IRS has also made critical progress in improving international tax compliance. Through our strategic enforcement efforts and parallel voluntary disclosure programs, the IRS has provided opportunities for U.S. taxpayers with undisclosed offshore accounts or income to come back into the tax system. Since its establishment in 2009, the Offshore Voluntary Disclosure Program has resulted in more than 43,000 disclosures of underpaid or unpaid taxes and the collection of more than \$6 billion in back taxes, interest and penalties. In addition, our work on offshore tax evasion has recently included: the prosecution of three foreign banks for conspiracy to commit tax evasion resulting in restitution of \$807.5 million and forfeitures of \$48.3 million; indictments of almost two dozen foreign bank employees and investment advisors; and more than 100 indictments of U.S. citizens with hidden offshore accounts.

Another key enforcement challenge for the IRS is refund fraud, especially fraud caused by identity theft. The IRS has a comprehensive and aggressive identity theft strategy that focuses on preventing refund fraud, investigating these crimes, and assisting taxpayers victimized by identity thieves.

Regarding our fraud detection efforts, the IRS stopped 5 million suspicious returns in Calendar Year 2012 – up from 3 million suspicious returns stopped in CY 2011. This upward trend has continued: in CY 2013, we suspended or rejected 5.7 million suspicious returns, worth more than \$17.8 billion. Over the last two fiscal years, the IRS has made numerous improvements in catching fraud before refunds are issued. For example, we have implemented new identity theft screening filters to improve our ability to spot false returns before we process the return or issue the refund. We hope that these improvements will help us continue this upward trend in CY 2014.

The IRS' current fraud detection capability is strong, but it is limited by the technology in place, so we are investing in a significant new set of technologies. For instance, the Return Review Program (RRP) will greatly expand our current efforts by enhancing our real-time filtering and identity theft modeling capabilities. We are rolling out the first version of RRP in 2014, and it will operate alongside the legacy Electronic Fraud Detection System until 2016, when RRP will become our primary fraud detection system. Once RRP is fully implemented, we will have

more flexibility to stay ahead of identity thieves because we will be able to act more quickly to incorporate what we learn about fraud schemes into our filters.

The IRS has also been working to improve its efforts to assist victims of identity theft. Today, the IRS has 3,000 people working directly with victims on identity theft related cases – more than double the number of people working on these types of cases in 2011. In addition, since 2012 we have trained 40,000 employees who regularly work with taxpayers to help with identity theft situations when they arise. In CY 2013, the IRS worked with victims to resolve and close approximately 963,000 cases.

The IRS has reengineered its identity theft reporting and resolution processes to close cases more efficiently, accurately, and with less burden to the victim. In FY 2013, taxpayers who became identity theft victims received their refunds and had their account issues resolved in roughly 120 days, far more quickly than in previous years when cases could take over 300 days to resolve. We continue to look for ways to shorten the time to resolve identity theft cases and ease the burden that identity theft places on these victims.

The IRS created the Identity Protection Personal Identification Number (IP PIN) to help reduce identity theft and to permit victims of identity theft a safer means of filing their tax returns in subsequent years. The IP PIN is a unique identifier that authenticates a return filer as the legitimate taxpayer at the time the return is filed. As of December 31, 2013, we have issued more than 1.2 million IP PINs for the 2014 filing season. Also new this year, we are offering a limited pilot program to test the idea of issuing IP PINs to individuals who have not previously been identity theft victims, but who reside in three locations – Florida, Georgia, and Washington, D.C. – with high incidences of identity theft. Based on the results of this pilot, IRS will consider whether to expand issuing IP PINs prospectively to taxpayers in other locations.

The investigative work done by the IRS is a major component of our efforts to combat tax-related identity theft. CI investigates and detects tax and other financial fraud, including fraud related to identity theft. Investigations of tax fraud related to identity theft have increased significantly over the past three fiscal years. The number of investigations opened increased from fewer than 400 in FY 2011 to 900 in FY 2012, and increased again to nearly 1,500 in FY 2013. Indictments in identity theft-related cases totaled 1,050 in FY 2013, with 438 individuals sentenced and an average time to be served of 38 months.

### **Implementing Enacted Legislation**

As noted, one of my priorities as Commissioner is to ensure that the IRS fulfills its responsibilities to implement tax-related provisions of enacted legislation. A large portion of our efforts in this regard continue to center on the ACA and FATCA. The resources needed for implementation activities for ACA and

FATCA, taken together, represent roughly 4 percent of the IRS' budget for FY 2014.

### *ACA Implementation Efforts*

With regard to ACA implementation, I am pleased to be able to tell you that the systems and processes that the IRS developed to support enrollment in the new Health Insurance Marketplace were launched on schedule and are working as planned. In addition, the IRS has been working to implement the ACA's tax provisions, most of which are already in effect, such as the branded prescription drug fee, the tanning tax, and the medical device excise tax. We continue to focus on two significant provisions that go into effect in 2014: the premium assistance tax credit and the individual shared responsibility provision. These two provisions will have a profound impact on IRS forms and procedures beginning with the 2015 filing season, and will require additional taxpayer services and education activities.

Preparations are already well underway to modify forms and instructions, enhance education and outreach to taxpayers and their advisors, and update our systems and processes in time for the 2015 filing season.

The IRS is also focusing on ensuring that returns that erroneously or fraudulently claim refundable premium tax credits (or fail to reconcile advance payments of the credit) are efficiently identified and addressed, using Marketplace information available during the filing season as well as the ever-improving IRS tools used for all returns to address errors and fraud.

### *FATCA implementation efforts*

FATCA is an important new tool in our offshore compliance efforts, as it requires foreign financial institutions (FFIs) to report information to the IRS about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. Withholding requirements under FATCA go into effect on July 1, 2014. Last week the IRS and Treasury released two important additional pieces of FATCA guidance for FFIs. The first piece of guidance responds to extensive comments, makes numerous corrective adjustments, and provides transition rules to the original regulations that were released last year. The second package of guidance includes provisions to coordinate FATCA reporting with pre-existing reporting and withholding rules that already affect international financial intermediaries and withholding agents. Both of these regulations are consistent with achieving FATCA's compliance goals, while trying to minimize burden.

It is important to note, however, that legal restrictions in some countries prevent FFIs from fulfilling the reporting, withholding and account disclosure requirements. For that reason, Treasury, with assistance from the IRS, is

advancing an intergovernmental approach to FATCA implementation that is focused on bilateral agreements that address these legal impediments, simplify practical implementation and reduce the costs to FFIs. As of Feb. 22, there were 22 signed Intergovernmental Agreements. The IRS FATCA registration website opened in August 2013 allowing financial institutions to begin to enter data. In January 2014 financial institutions were able to begin submitting their electronically signed FATCA agreements.

### **Exempt organizations**

The IRS is continuing its efforts to implement broad managerial and operational improvements in the determination process for tax-exempt status. In this work we are focusing on applications for recognition of tax-exempt status under both sections 501(c)(3) and 501(c)(4).

#### *Section 501(c)(4) organizations*

Regarding the section 501(c)(4) application process, the IRS has made important progress in addressing the concerns raised by the Treasury Inspector General for Tax Administration (TIGTA) in a May 2013 report describing problems with the processing of these applications. In fact, I am pleased to report that the IRS completed action on all nine TIGTA recommendations contained in that report as of the end of January 2014.

The changes we have made in response to the TIGTA recommendations include:

- Establishing a new process for documenting the reasons why applications are chosen for further review;
- Developing new training and workshops on a number of critical issues, including the difference between issue advocacy and political campaign intervention, and the proper way to identify applications that require review of political campaign intervention activities;
- Establishing guidelines for IRS Exempt Organization (EO) specialists on how to process requests for tax-exempt status involving potentially significant political campaign intervention; and
- Creating a formal, documented process for EO determinations personnel to request assistance from technical experts.

We have reduced the inventory of section 501(c)(4) applications, including the group of 132 cases in the “priority backlog” – those that were pending for 120 days or more as of May 2013. As of February 7, 2014, 112 of those cases, or 85 percent, have been closed. Of the closed cases, 85 of them were approved, including 40 organizations that took advantage of a temporary self-certification procedure we offered in summer 2013. Of the remaining 27 closed cases, most were closed either because the organization withdrew the application or it failed to respond to our questions. To date, three applications have been formally denied. The 20 cases still open generally fall into one of two categories: either

the taxpayer has asked for (and received) additional time to respond to our questions, or the case is being litigated.

In addition, proposed regulations were released in November that are intended to provide clarity in determining the extent to which section 501(c)(4) organizations may engage in political activity without endangering their tax-exempt status. This initial guidance also seeks comments on other aspects of the section 501(c)(4) qualification requirements, including what proportion of an organization's activities must promote social welfare. There are a number of steps in the regulatory process that must be taken before any final guidance can be issued.

I believe it is extremely important to make this area of regulation as clear as possible, not only because it will help guide the IRS in proper enforcement, but because it will also give a better roadmap to applicants and help those that already have section 501(c)(4) status understand the applicable standards and properly administer their organizations. The proposed guidance also seeks comments regarding whether standards similar to those that have been proposed should be adopted to define the political activities that do not further the tax-exempt purposes of other tax-exempt organizations, which would promote consistent definitions across the tax-exempt sector.

The Treasury and IRS have requested public comment on the proposed regulations, and to date more than 68,000 comments have been received. The comment period closes tomorrow, and I can assure you that the Treasury and IRS will carefully consider all public feedback in working to ensure that the standards for tax exemption under section 501(c)(4) are clear and can be applied consistently.

#### *Section 501(c)(3) organizations*

Improving the section 501(c)(3) application process is a significant area of focus for our agency, and we have been working diligently to make the process less burdensome for applicants in a number of ways.

Our Exempt Organization (EO) group consistently receives more than 60,000 applications per year, including primarily applications for section 501(c)(3) status (as well as other types of tax-exempt status). The agency has experienced a substantial rise in applications since 2010. In FY 2013, for example, we received nearly 80,000 applications for recognition of exemption. The automatic revocations of tax-exempt status that occurred under the 2006 Pension Protection Act beginning in 2011, and the subsequent requests for reinstatement, have been a significant cause of this increase.

Those requests for reinstatement have added more than 50,000 cases to EO's workload since FY 2010. In fact, in 2013, more than 30 percent of the applications we received were from organizations seeking reinstatement

following automatic revocation. On January 2, 2014, the IRS issued Revenue Procedure 2014-11, which will make the reinstatement process more efficient for organizations whose status was automatically revoked and will allow a majority of revoked organizations to use a streamlined process to apply for retroactive reinstatement of their exempt status.

Looking beyond the issue of automatic revocations, the IRS has recently developed another way of making the determination process more efficient for section 501(c)(3) organizations. The Interactive Form 1023, *Application for Recognition of Exemption under Section 501(c)(3)*, which was made available online in September 2013, features pop-up information boxes that offer guidance on what information is needed. The form should result in more complete applications, thus reducing processing time by minimizing the IRS' need to request additional information to make a determination.

We are also examining the feasibility of creating a streamlined application process for certain organizations seeking tax-exempt status. I recently visited the Cincinnati IRS office and had the opportunity to meet with members of our Lean Six Sigma<sup>1</sup> team that is taking the lead on this effort. I'm excited about the work that these dedicated frontline employees are doing. They are developing a process that could potentially be used by small organizations that pose a low risk of noncompliance. The goal is to come up with a new procedure that is more efficient without introducing major risks into the system for approving applications.

We presently have a backlog of 60,000 section 501(c)(3) applications, many of them well over a year old. Our goal is to be able to report a significant decrease in this number by this time next year.

## **IRS Budget**

For the IRS to keep making progress in all the areas mentioned above, it is critical for us to receive adequate resources. The agency continues to be in a very difficult budget environment, with our funding for FY 2014 now set at \$11.29 billion. Since FY 2010, IRS appropriations have been cut by approximately \$900 million. This represents a 7 percent cut in our annual budget since 2010 while the total population of individual and business filers grew by more than 4 percent over the same time period.

We recognize the need to become more efficient no matter what happens to our funding level. Labor is our largest operating expense and we have been very focused on managing personnel costs. By closely managing hiring and limiting

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<sup>1</sup> Lean Six Sigma is a management reengineering methodology widely used in the private sector to improve business performance.



replacement behind attrition, the IRS has reduced the total number of full-time, permanent employees by about 10,000, or more than 11 percent, since 2010.

The IRS has also implemented significant reductions in its non-labor spending. Since 2010, the IRS has limited employee travel and training to mission-critical projects. By our estimates, training costs have been reduced by 83 percent and training-related travel costs have been reduced by 87 percent since 2010. We have expanded the use of alternative delivery methods for in-person meetings, training, conferences, and operational travel, but we need to restore some of these funds to ensure that IRS employees interacting with the public are properly trained and able to provide the answers and assistance expected.

Over the same period, the IRS also reduced spending on professional and technical service contracts by \$200 million. Additionally, the IRS generated \$60 million in printing and postage savings by eliminating the printing and mailing of selected tax packages and publications, and by transitioning to paperless employee pay statements.

Finally, in an effort to promote more efficient use of the Federal government's real estate assets and generate savings, in 2012, the IRS announced a sweeping office space and rent reduction initiative that over two years is projected to close 43 smaller IRS offices and consolidate space in many larger facilities. These measures will reduce rent costs by more than \$40 million and reduce total IRS office space by more than 1.3 million square feet by the end of FY 2014.

We will continue our efforts to find savings and efficiencies wherever we can. The IRS will continue to carry out its core responsibilities and work toward preserving the public's faith in the essential fairness and integrity of our tax system. But these budgetary constraints continue to pose very serious challenges to our efforts to enforce the tax laws and provide excellent customer service. Essentially, the federal government is losing billions in revenue collection to achieve budget savings of a few hundred million dollars. In general, IRS estimates that for every \$1 invested in the IRS budget, it produces \$4 in revenue – a 4-to-1 return.

With the IRS budget now in its fourth year of relative decline, significant effects on taxpayer services will become more apparent during the 2014 filing season. The IRS will have 11,000 fewer people working during the 2014 filing season than it had in 2010 while processing the largest number of tax returns in the agency's history. As a result, we expect that taxpayer service will be impacted this filing season as follows:

- The IRS will not be able to deliver timely service to taxpayers who phone us for tax assistance. We estimate that 18 million calls to our help lines, or 39 percent, will go unanswered this year, including at least 2 million calls from small businesses;

- The average wait time for taxpayers on the phone is expected to potentially rise to around 25 minutes per call, compared with 10 minutes in 2010; and
- The backlog of taxpayer correspondence is expected to increase significantly during the filing season, and we estimate that it will take more than 45 days to answer at least half of these letters. (Historically, 70 percent of taxpayer correspondence is answered within 30 days.)
- Taxpayers will bear the burden of a reduction in the IRS's budget because, as Forbes magazine recently noted, a reduction in IRS funding that erodes service levels "punishes" taxpayers.

In addition, earlier this year the IRS announced the elimination of two e-service offerings for professional tax preparers: Disclosure Authorization and Electronic Account Resolution. Although we worked to eliminate offerings with the lowest historical usage rates, this change still generated a great deal of concern among preparers who used the services. Unfortunately, given how tight our budget situation is, and will continue to be, we were not able to restore these services.

It is important to note that any marked deterioration in taxpayer service could create serious long-term risk for the U.S. tax system, which is based on voluntary compliance. The National Taxpayer Advocate has pointed out that approximately 98 percent of IRS tax collections in FY 2012 resulted from voluntary payments made by taxpayers. Because the IRS each year is responsible for collecting more than 90 percent of all federal tax receipts, even a small decline in voluntary compliance could have a noticeable impact on revenue.

The ongoing tight budget environment will also have a significant impact on enforcement activities. For example, we estimate that in FY 2014:

- Examinations conducted by the IRS will decline by an estimated 100,000 from FY 2013;
- The number of collection activities will decline by an estimated 190,000 from FY 2013; and
- IRS Appeals staff will process 8,000 fewer cases than in FY 2013, leaving taxpayers with more uncertainty and less ability to resolve issues they may have with regard to their tax liabilities.

Staffing needs will continue to be a significant concern under FY 2014 funding levels. Even though overall funding is consistent with FY 2013, IRS continues to need to reduce staffing to offset the cost of a government-wide 1 percent salary adjustment in January and eliminate the need for furlough days (three of which were taken by IRS employees in FY 2013). Under these budget constraints, we anticipate the number of full-time equivalents would decline by another 2,000 in FY 2014.

IRS Information Technology (IT) operations are another area that will see a significant impact from the continuing tight budget environment. We anticipate that funding in this area in FY 2014 will not be sufficient to address critical technology infrastructure needs such as: improvements to IRS.gov, our main portal for taxpayers to receive online assistance; new identity theft prevention tools; and upgrades to the basic computer software used by our employees that is needed to reduce system vulnerabilities.

Given our difficult budget situation, I note that questions have been raised about the agreement we recently reached with the National Treasury Employees Union (NTEU) involving FY 2013 performance awards for Bargaining Unit (BU) employees. As a result of sequester, the IRS initially made the tough decision to eliminate performance awards for FY 2013. However, because of negotiations with the NTEU that were already underway when I came on board in December, the IRS eventually agreed to make performance award payouts for FY 2013 of about 1 percent of the BU employee salary base, which is less than the 1.75 percent provided to these employees in previous years. It is important to note that these performance award payouts are awards based on the BU employee's performance and that these performance awards go to approximately two-thirds of the BU employees, based on decisions by their managers.

The agreement reached by the IRS and the NTEU is important for a number of reasons. First, it settles a national grievance and unfair labor practice charge, and provides performance awards to employees who had no pay raises for four years up until this year. In addition, as a result of this agreement, BU employees will for the first time be on the same schedule as everyone else at the IRS, so that payouts will be made early in the fiscal year for work performed the previous year.

After spending time with many employees in various IRS offices over the last several weeks, I am convinced that this money is best spent on our employees. I firmly believe that this investment in our employees will directly benefit taxpayers and the tax system.

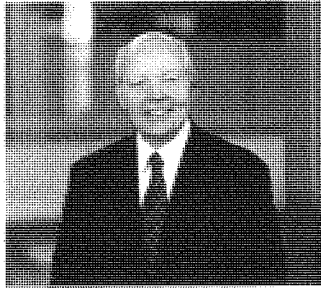
Once again, I believe that it is vital for the IRS to receive adequate funding going forward in order for us to deliver on our dual mission of enforcing the tax laws and providing excellent taxpayer service. This view is shared by the IRS Oversight Board, the National Taxpayer Advocate, TIGTA, and the Internal Revenue Service Advisory Council.

### III. CONCLUSION

Chairman Crenshaw, Ranking Member Serrano and members of the Subcommittee, thank you again for the opportunity to provide you with an overview of IRS operations. Our work in all of the areas I have discussed is

critical, and despite some recent successes, more needs to be done. Going forward, our biggest obstacle to further progress in all areas, including taxpayer service, will be our significantly reduced level of funding. As I recently told our employees, it is important for us to remember that the challenges and problems we face won't be solved overnight. But I am confident that, working together, and with the help of Congress, we can meet those challenges and ensure that our agency can continue to deliver for the American taxpayer in the years to come. This concludes my statement, and I would be happy to take your questions.

## Commissioner John Koskinen



**John Koskinen** is the 48th IRS Commissioner. As Commissioner, he presides over the nation's tax system, which collects approximately \$2.4 trillion in tax revenue each year. This revenue funds most government operations and public services. Mr. Koskinen manages an agency of about 90,000 employees and a budget of approximately \$11 billion.

In his role leading the IRS, Mr. Koskinen is working to ensure that the agency maintains an appropriate balance between taxpayer service and tax enforcement and administers the tax code with fairness and integrity.

Prior to his appointment, Mr. Koskinen served as the non-executive chairman of Freddie Mac from 2008 to 2012 and its acting chief executive officer in 2009. Previously, Mr. Koskinen served as President of the U.S. Soccer Foundation, Deputy Mayor and City Administrator of Washington D.C., Assistant to the President and Chair of the President's Council on Year 2000 Conversion and Deputy Director for Management at the Office of Management and Budget. Mr. Koskinen also spent 21 years in the private sector in various leadership positions with the Palmieri Company, including President and Chief Executive Officer, helping to turn around large, troubled organizations. He began his career clerking for Chief Judge David L. Bazelon of the DC Circuit Court of Appeals in 1965, practiced law with the firm of Gibson, Dunn and Crutcher and served as Assistant to the Deputy Executive Director of the National Advisory Commission on Civil Disorders, also known as the Kerner Commission. Mr. Koskinen also served as Legislative Assistant to New York Mayor John Lindsay and Administrative Assistant to Sen. Abraham Ribicoff of Connecticut.

Mr. Koskinen holds a Law Degree from Yale University School of Law and a Bachelor's Degree from Duke University. He also studied International Law for one year in Cambridge, England. He and his wife Patricia have two grown children and live in Washington, DC.

## SPENDING PRIORITIES

Mr. CRENSHAW. Let me start the question process. You know, in my opening statement, I mentioned the issue about responding to the questions that people have. You just mentioned that 40 percent of the calls, I think, went unanswered.

As we have this oversight hearing and we talk about how you spend the money, I want to pursue how you make decisions in terms of priority. In other words, where do you decide to spend money and where do you decide you are not able to spend money when you have limited resources?

By the way, this subcommittee oversees about 30 different agencies, and your agency receives the largest amount of money. In fact, it receives more than half of all the money that we are allocated to distribute to these agencies. So we have to make decisions in terms of priority—who is spending their money wisely, who is not. You obviously have a lot of leeway to make those decisions with the IRS.

And it seems to me that one of the most important things you do is deal with customer services. You are like the front door; the phone call is the entryway to the IRS. That is a lot of people's first contact with the IRS, when they make a phone call. If they find that half of their phone calls aren't going to be answered and if they do get answered they are going to have to spend up to 20 minutes waiting, then that is not a very good perception of the general public to have about the IRS and its operations of business.

Now, I want you to tell this Committee how you make that decision. Because here is what bothers me. There is an old trick in this town where, anytime you need more money, you pick out the most visible service that you offer and one that maybe inflicts the most pain on people, and then you say, "We can't do that unless we have more money." It is like you turn out the lights in the Washington Monument because we don't have enough money. When the sequester came, people said, well, we can't have tours of the White House because we don't have enough money; we won't let the veterans go visit the World War II Memorial because we don't have enough money.

I am not suggesting that you are using that old trick, but sometimes I have to wonder, when you have \$11 billion and you have to make these decisions, it seems to me that one of the priorities ought to be to interact with people.

So tell the subcommittee how you go about making that decision. Because I looked back 10 years; in 2004, 87 percent of the phone calls got answered. And that was a time when the IRS had \$1 billion less than it has today. I know you have more responsibility and all those kind of things, but my point about how you spend the money is just as important sometimes as how much you have to spend.

So tell us, if you will, do you ever think about, well, we have rent, we have technology, we have certain other things—and, obviously, in this case, you had \$63 million to pay the bonuses, and you are pursuing a rule that arguably clarifies things but some people would say it goes in the wrong direction. So what goes through that decision-making process to decide where the money gets spent?

Mr. KOSKINEN. That is a good question. We spend a lot of time worrying about that question, especially trying, as I say, to make sure we spend the money most effectively.

We do some things about which we have no choice. We have no choice about a filing season, which is why we spent a tremendous amount of time and effort making sure it went well this year. Part of the reason it is going well is we haven't had any major tax law changes. So I agree with you that the simpler the Tax Code is, the better the filing season would go. But that is a critical function—that is our highest priority.

We also do have statutory mandates. If you tell us to do something, we will do it. So this year we are spending a significant amount of time implementing the Affordable Care Act and the Foreign Account Tax Compliance Act. We don't feel we have any choice about that; the mandate comes from Congress that we should perform that.

Seventy-five percent of our budget is personnel. As I said, we have 10,000 fewer people than we had 4 years ago doing significantly more work, including the requirements that we implement those statutes.

So we have to make decisions, and the only places we have discretion are, in fact, in tax enforcement and in taxpayer services. We have 3,500 fewer people doing enforcement, Revenue Agents and Revenue Officers. We have 1,500 fewer people answering the phones. So we have made more cuts on the enforcement side than on the call side.

But they are two sides of the same coin. Ultimately, we depend upon voluntary compliance. And I am concerned, as you are, that if we can't provide adequate taxpayer service, we are going to undercut the core mission of the Agency. As you noted, 98 percent of our money, as the Taxpayer Advocate has said, comes from voluntary compliance. Only 2 percent of the revenues come from our enforcement efforts, although that is \$50 billion to \$60 billion, which is a lot of money.

So we need to protect the process as it goes forward. But it is not a question of just a few dollars one way or the other. We did have, and our goal would be to return to, those days when we had 85, 80 percent service on telephone calls, so you don't have to wait more than 5 or 7 minutes and your call will go through.

Mr. CRENSHAW. But is it a priority? And when you look at rent and you look at your contracts, do you say, gee, if we could save some money here, save some money there, we could actually answer more phone calls? Is that pretty high up in your priority list?

Mr. KOSKINEN. By the end of this year, we will already be using 1,300,000 square feet less of office space. We will save \$40 million a year with that. At the end of this year, we will save \$60 million by not producing all the publications we used to, and by not mailing them out to everybody. You know, none of us anymore get the old 1040 forms in the mail. That saves us \$60 million. We have cut the use of contractors by \$200 million a year.

So we already have \$300 million a year in annual savings. And we are continuing to look at ways to do better than that, and we will be happy to share that information as we develop it.

But what we are thinking about—

Mr. CRENSHAW. My time is up. I appreciate that. I just think that that ought to be a big priority, and I hope it is.

So let's go now to Mr. Serrano.

#### EMPLOYEE MORALE

Mr. SERRANO. Thank you, Mr. Chairman.

You have been on the job now at the IRS just over 2 months, but you have spent 21 years in various public- and private-sector leadership positions. Because of your previous experiences, I would be interested in hearing what your first impressions of the IRS are.

In particular, I understand that you have been going on a listening tour in the district offices. What have you been hearing from employees? And I would also like to know what the morale is of the employees after the hits that—

Mr. KOSKINEN. Right.

Mr. SERRANO [continuing]. Many have taken for the behavior of a few.

Mr. KOSKINEN. It is an important question. I am on, as I have said, the "join the IRS, see the United States" tour of the 25 major IRS offices. I am doing that primarily because my experience in the 20 years in the private sector as well as my 20 years in the public sector, has been the people who know best about what is going on in an organization are the people actually doing the work on the front lines. So I am listening to employees. I hold a town hall at everyplace I go, with 200 to 300 employees, who will ask me any question they want. I have lunch with 15 randomly selected employees to listen to what they have to say.

And after the couple months I've been here—and I have had briefings, obviously, with everybody running any department of any significance at the IRS—I have been thoroughly impressed with the professionalism, the skill, the dedication to the mission of all of the employees.

What surprised me a little when I went through these meetings—I started in Cincinnati, I have talked with the Chairman and I was in Jacksonville, and I have been in others. I have been in eight cities; I am off to Fresno tonight—What has surprised me is the level of energy and enthusiasm that remains. These are employees, like all Federal employees, who haven't had a pay raise in 4 years, who suffered through the government shutdown, who suffered with furlough days, and then had to endure the criticism over the last 8 to 10 months about the Agency. So you would expect that what I would hear would be a lot of grumbling or complaining.

What I have heard continually across those 10 cities I have been to already is that the employees' primary concern is there aren't enough people in the offices for them to help taxpayers. I have sat in call centers in Baltimore, call centers in Saint Louis. The people, their concern is not that they are overworked; they are working as hard as they can. Their concern is that there aren't as many people as there used to be answering phone calls, and, therefore, they don't feel they are delivering taxpayers the services they deserve. The people at the Taxpayer Assistance Centers who run those centers, oftentimes with empty desks, are also concerned about the people standing in line.



So, to me, it is a refreshing indication of the dedication the 90,000 employees working for the IRS have to meeting, and I think the Chairman is exactly right, the mission of the Agency to provide taxpayers the services they deserve if we expect them to be able to comply with the Tax Code.

Mr. SERRANO. So, in general, you think that the feelings of the staff is one of, let's get the job done, notwithstanding the bad publicity caused by some and the shortage in personnel?

Mr. KOSKINEN. That has been my experience, and it has surprised me. I thought I would hear either more grumbling about the fact they hadn't had a pay raise in 4 years or about the fact that they were working overtime because of the lack of personnel. And, as I say, I have seen, at last count, and personally talked to over 3,000 employees in offices with 20,000 employees in them, and the constant theme has been: We need more people to allow us to do the work.

Mr. SERRANO. Well, I think it is always a good time, and so I will take it now, to thank our Federal workers. I know there is a small number of Members of both parties who would like to see no Federal Government, but that is another issue for another hearing, not this one. I have great respect for the Federal workers and the work that they do.

#### REVIEW RECOMMENDATIONS

Let me ask you a question. Former Acting Commissioner Werfel conducted an internal review that President Obama requested to restore trust in the IRS. Have the recommendations in that review been carried out? Are there other changes that you think would be helpful? If so, how can this committee assist you?

Mr. KOSKINEN. We have implemented and responded to, positively, all of the nine recommendations from the Inspector General focused on the 501(c)(4) situation. We also have done broader reviews of efficiencies in the organization, again, trying to be able to respond more effectively to the demands that have been placed on the organization.

Mr. SERRANO. How is my time, Mr. Chairman?

Mr. KOSKINEN. I think it is a yellow sign.

Mr. CRENSHAW. There is a yellow sign, which means "caution," and there are 30 seconds left.

#### SEQUESTRATION

Mr. SERRANO. Just one more question then. The IRS budget was reduced \$660 million due to the sequester. What was the effect on your operations based on that reduction?

Mr. KOSKINEN. We expect that if we had had the pre-sequester number—not the President's request for 2014, the pre-sequester number—we would have been able to answer this year another 3½ million calls, we would do another 100,000 audits, and we would collect approximately \$3 billion more in our enforcement activities.

[The information follows:]

Customer Service Representative Level of Service calculation.

The numerator equals the assistor calls answered plus the automated calls answered through subject matter messages. The denominator equals the numerator plus emergency close disconnects plus taxpayers that abandon in queue waiting for

Customer Service Representative assistance plus busy signals and disconnects generated by announcements that advise the taxpayer of high demand and request the taxpayer return his or her call at a later time.

Mr. SERRANO. All right.

Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you, Mr. Serrano.

We will turn to Mr. Diaz-Balart.

Mr. DIAZ-BALART. Thank you very much, Mr. Chairman.

I am glad to have you here, sir.

Mr. KOSKINEN. Thank you.

#### TECHNICAL ADVICE MEMORANDUM

Mr. DIAZ-BALART. Let me throw out two issues, if I may.

One is one that I have been dealing with your predecessors, frankly, for quite a long time. And, unfortunately, the IRS has not always acted in good faith, actually at one time admitting to me in front of a number of people that they had been instructed to not tell me the truth, in other words, to mislead Members of Congress. The issue pertains to a specific IRS—

Mr. KOSKINEN. I am not aware of that situation.

Mr. DIAZ-BALART. I know.

Mr. KOSKINEN. That will never be my circumstance—

Mr. DIAZ-BALART. Right.

Mr. KOSKINEN [continuing]. I can assure you of that.

Mr. DIAZ-BALART. Right. Right. Well, I will tell you, I was pleased that they at least admitted to me that they were—the person said, I was not authorized to tell you the truth, which I thought was a sad day, but you better believe that is something that I hope will never happen again.

It pertains to an IRS-specific ruling. It is a technical advice memorandum, or TAM, that all of the outside experts say it calls into question 70 years of settled law on the definition of political subdivisions, which is a—you know, there are many of them around the country, including in Florida.

This TAM effectively makes changes—makes a change to the law, and it is retroactive. So, obviously, this is not something the IRS should be doing in a TAM. If it wants to change a law, it should either come to Congress or at the very least propose regulations to make the changes prospective.

It is calling into question millions of dollars of tax-exempt bonds already in the hands of investors, not only, by the way, of this individual group, this entity that is affected by it, but also many, many others around the country, to the point where economic development projects in Florida and other States have been halted as a result of this TAM. And those who have gone forward are having to pay higher interest rates because of the vagueness of this TAM.

So, Commissioner, I have been trying to deal with this with your predecessors, and we have been misinformed. The chairman is very aware of this. I just need your commitment that you are going to look at this in a serious way to make sure that the IRS is not doing things in a way that—and retroactively in a way that is, in essence, changing 70 years of State law through a TAM.

Mr. KOSKINEN. I will be pleased to look into that and get back to you.

Mr. DIAZ-BALART. And, again, I don't expect you to have the details right now. We will get back to—we will—but I do expect to get together with you, and let's try to solve that.

Mr. KOSKINEN. That is fine. I will be delighted to talk with you about that further.

#### REAL TIME TAX SYSTEM

Mr. DIAZ-BALART. Thank you.

The other issue is, let me switch gears, it is the IRS's plans—there are no plans to move forward with the Real Time Tax System. This subcommittee has placed report language in our annual appropriations bills, by the way, since 2009, prohibiting the IRS from using any funds on a simple tax return pilot program associated without seeking specific authorization or appropriations from the Congress. That language has been there.

In February 2013, I sent a letter to Acting Commissioner Miller then requesting that he confirm in writing that the IRS expenditures to convert to a Real Time Tax System had ceased. The Commissioner wrote back saying that, quote, "The IRS is not in the process of implementing a conversion to a Real Time Tax System."

Unfortunately, later I learned that there has been money spent on that and that there have been plans under way. I tried to find out how much it was. I asked the IRS how much funding had been spent on a total Real Time Tax System. The response was that there was a contract for approximately \$3.54 million to explore a system, sir, that Congress has specifically said it can't do and the IRS had told us that they weren't going to do.

Later I hear from other Committees—the House Government Reform Oversight Committee has recovered additional documents from the IRS that shows that the amount spent by the IRS in the Real Time Tax System could be as much as \$30 million. I can't confirm that.

So two final questions. Are you aware of any further exploration and implementation by the IRS of any data-collection system related to the Real Time Tax System, number one? And, again, because that language in the appropriations bills since 2009 seems to have been absolutely systematically ignored. And will you pledge to adhere to the report language in the current fiscal year 2014 omnibus?

And, again, what I am asking is also 100 percent transparency to this subcommittee, to members of this subcommittee, on the other issue but also on the Real Time Tax System.

Mr. KOSKINEN. I am happy to commit that we will follow all of the instructions, whether you give them to us personally or in legislation, because I think that is important for us to be able to do.

With regard to the Real Time Tax System, part of the problem is that all sorts of different systems have been called "Real Time Tax." The thing that has been the focus of a lot of external discussion is the idea of the IRS pre-populating a return form—get the information in, pre-populate the return so you could look at it, and then you could make decisions, or the IRS could even file your return for you. And that is what a lot of people have talked about as being the Real Time Tax System.

Mr. DIAZ-BALART. Correct.

Mr. KOSKINEN. We are not doing anything with that. It would take a long time to be able to do that.

We do have work going on to try to figure out how to get better third-party information into our system earlier so, as we actually match up tax returns for identity theft or are engaged in audits, we will have more data available in a more timely manner. Right now we don't get the W-2 forms from Social Security or the 1099 forms until late in the spring, which doesn't do us much good, as everybody is filing in January or February.

So some people internally have called that a Real Time Tax System, but it has nothing to do with the program that you are talking about. And we have no program going forward that I know of. Certainly we don't intend to do anything like that without talking to you.

[The information follows:]

The IRS is not pursuing and has no plans to implement a Real Time Tax system to create pre-filled forms or software/products for simple tax return preparation. Our exploration during 2011–2013 of earlier use of available data complies with the U.S. House of Representatives Committee on Appropriations statement (House Report 112–550) that prohibits the IRS from pursuing a simple tax return program.

The Deputy Chief Information Officer, Strategy and Modernization; the Deputy Commissioner of the Wage and Investment Division; and the Director of Wage and Investment Business Modernization Office led an ad hoc team to explore the earlier use of available information return data during 2011–2013, which then-Commissioner Shulman referred to as “Real Time Tax.” This concept is very different than creating a pre-filled form or software/products for simple tax return preparation, which is often referred to as a Real Time Tax system, and which we are not pursuing nor have any plans to implement. The team included approximately ten employees that developed and refined a working vision statement and identified a preliminary set of business focus areas. Contractor support was provided by Booz Allen Hamilton and Accenture. The total contract costs were approximately \$3.54 million. IRS Real Time Tax exploration concluded in 2013 and there have been no other costs.

Mr. DIAZ-BALART. Thank you, Mr. Chairman.

I look forward to working with you, Commissioner, on these two areas, also on identity theft and other issues.

Mr. KOSKINEN. Good.

Mr. DIAZ-BALART. Thank you, sir.

Mr. CRENSHAW. Thank you.

Mr. Quigley.

#### EDUCATION AND ASSISTANCE

Mr. QUIGLEY. Thank you, Mr. Chairman.

Welcome, Commissioner.

In addition to everything else you have going with the IRS, this is an historic filing period. The Defense of Marriage Act was struck down last June by the Supreme Court, and so, for the first time, same-sex couples will be filing Federal tax returns together. This is the first filing period that that is taking place.

What education within the IRS and outside the IRS is taking place? How are you helping to educate the public and making resources available to people, particularly with some of the complexities involved? As you know, different States have different laws, and I have residents in my district and in my State who were married in Iowa, for example. Illinois is just now beginning to recognize same-sex marriages. So what is the IRS doing to deal with these complexities?

Mr. KOSKINEN. Well, I think it is important. One of the things that did surprise me back there in Congressman Serrano's question is the amount of outreach the IRS does, as a general matter, to taxpayers. We have a Web site which, if you look at it today, is a very different Web site than it was a year ago, in the sense of trying to be more user-friendly, to provide information taxpayers need directly.

We have wonderful partnerships with tax preparers, who actually advise tax payers—we give them information. We share information about what information their clients will need.

We have a YouTube channel with over 100 instructional videos about what you should worry about. We just put out our first advice to taxpayers this week about starting to look forward to how to deal with the Affordable Care Act, particularly advising taxpayers, if their circumstances change during the year, they need to adjust whatever Premium Tax Credit they are getting.

In regards to the Defense of Marriage Act, we have been putting out reminders to people, like we remind people when it is time to pay their estimated taxes. So there is a tremendous amount of time spent reaching out to taxpayers, trying to educate them as much as we can about the Tax Code.

As I somewhat facetiously said, it may take a while before I can convince people that we are from the IRS and we are here to help you. We do spend a significant amount of time doing just what you are talking about, which is, prior to the filing season and during the filing season, to give people as much information as they can get.

So this year, for instance, we are advising people: don't call if you need to find about where your refund is; go to the Web site, push the tab. And last year 250 million people got information about, quote, "Where is my refund?" This year, for the first time, you can go to the Web site, authenticate who you are, get transcripts of your previous filings, and you can print them out at home. You don't have to come to an assistance center; you don't have to call.

So it goes partially to the Chairman's concern, which I have, which is we can't just sit around and say, "Gee, what will we do?" We have spent a lot of time trying to say, what information do taxpayers need, what do they call about, how much of that could we give them in some other channel of communication?

We also have tweets—I mean, we do things that I don't know how to do.

Mr. QUIGLEY. But, sir, you recognize these are unique circumstances.

Mr. KOSKINEN. Those are unique——

Mr. QUIGLEY. This is——

Mr. KOSKINEN [continuing]. Circumstances.

Mr. QUIGLEY [continuing]. The first time in history this is taking place——

Mr. KOSKINEN. Yes.

Mr. QUIGLEY [continuing]. And a lot of taxpayers need additional assistance. All the resources you are talking about are helping these new filings.

Mr. KOSKINEN. Right. And the people who are on the phones have information about that. So if taxpayers call and get through,

they will be able to get that kind of information. But it is also on the Web site. We have, as I say, tried proactively in all of these areas to get information out to taxpayers before they fill out their returns, and even before they feel they have to call.

#### IDENTITY THEFT

Mr. QUIGLEY. Well, we appreciate that.

Your predecessor talked about the cases of identity theft, said that there were nearly 250,000 reported to your agency in 2011 and 816,000 in 2012. Obviously, this is an alarming increase. What are you attributing this to, and what is the agency doing?

Mr. KOSKINEN. It has been an explosion since 2010 through, actually, last filing season in terms of people either borrowing, stealing, going to the Death Master Files, getting Social Security numbers, and filing false returns and trying to get refunds early.

We have spent time, as I was telling the Chairman earlier, in Jacksonville with the wonderful task force that, jointly between the IRS Criminal Investigation Division and State and local law enforcement in Jacksonville and Florida, have become much more aggressive at pursuing this. We last year had 1,500 investigations, up from 300 the 2 years before. We have a substantially more sophisticated filter system that identifies suspicious returns as they are filed electronically.

Last year, we actually saw a plateauing in the number of returns that came through that we were able to attack. So we had 1,000 indictments recommended last year, up from 165 two years earlier. We think we are getting some of the people off the street. We are, I think, getting the message out that this is not a free game, it is not a free good, that you can't simply buy or steal a Social Security number and get a refund without being prosecuted for that.

But it is a significant problem. We had in the budget proposed \$100 million of IT work that was not included in the Omnibus, but we are figuring in some other ways to fund it. And part of the \$92 million additional funding provided was for just this purpose, and we are spending it that way.

But it is going to be a problem—we think we have it under control. As I noted, we are able to resolve for taxpayers the identity-theft problems much faster than we used to, but it is one of the three or four highest priorities we have in tax administration.

Mr. QUIGLEY. Thank you.

Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you.

Mr. Graves.

#### 501(C)(4)

Mr. GRAVES. Thank you, Mr. Chairman.

Mr. Commissioner, a lot of discussion about the 501(c)(4)s earlier. What are some specific examples of 501(c)(4)s?

Mr. KOSKINEN. 501(c)(4)s cover a wide gamut. You know, they are everything from garden clubs to, in fact, advocacy groups. And, in fact, the vast majority of 501(c)(4) applications have nothing to do with political activity as they go forward. A relatively small percent are in that area.

So one of the issues, as we talk about the proposed draft regulations that everybody is focused on, is it really just political organizations that are involved. But, as I say, probably 90 percent of the 501(c)(4)s have nothing to do with political advocacy.

Mr. GRAVES. What is a specific example of a 501(c)(4), an organization that might come under scrutiny under this rule?

Mr. KOSKINEN. Well, under this rule, there would be any organization that is a social welfare organization, providing information to the public, that engages in political activity in a political campaign. So if you are an organization and you are providing information about any particular subject matter, that would be viewed as social welfare. If you then start running ads for a candidate in a campaign, supporting that, that would be political activity or campaign activity.

#### POLITICAL ACTIVITY

Mr. GRAVES. So is it not true, though, under the proposed definition, that it is any public communication that is made within a certain time period before an election would be considered candidate-related political activity if it identifies that candidate or a political office?

Mr. KOSKINEN. Right. Well, your question was what about a (c)(4) and what had historically been there. There is a draft regulation out, as the Chairman knows. We actually expect to have over 100,000 comments on it. And it is asking for just this discussion. That is what I assume the 100,000 comments are doing.

Mr. GRAVES. All right.

Mr. KOSKINEN. And it has three issues. One is, what should be the definition of political activity? What should be included as not appropriate for a social welfare organization, and what would be in that pool?

Then the next question is——

Mr. GRAVES. Is that not part of the proposed definition?

Mr. KOSKINEN. Pardon?

Mr. GRAVES. Is there not a proposed definition?

Mr. KOSKINEN. No, there is a proposed definition——

Mr. GRAVES. Okay.

Mr. KOSKINEN [continuing]. And comment is being asked for that.

Mr. GRAVES. Right, right.

Mr. KOSKINEN. So my position on it is——

Mr. GRAVES. But is that the proposed definition right now, the one I just read that deals with political activity as it relates to a candidate for a political office in the time period before an election?

Mr. KOSKINEN. Right, as has been out there and as proposed. The comment that people are making is, what are the options to that? Should it be applied at all? Should we stay with the facts-and-circumstance test we have had?

Mr. GRAVES. Let's assume that that proposed definition stays in place as it has been proposed by your——

Mr. KOSKINEN. I would like to not assume that, because I think that what we need to do is review the 100,000 comments, which I am going to be involved with——

Mr. GRAVES. Right.

Mr. KOSKINEN [continuing]. Because it is a joint regulation from Treasury and IRS. And as I have said in my prepared testimony, my goal is that whatever comes out of this, if there is a regulation—it is not guaranteed there will be—it be one that is clear, fair to everyone, and easy to administer. The IRS is not a political organization, and we ought to do whatever we can to get out of the politics of all this.

Mr. GRAVES. Right. So I just heard you say, then, that although it is a proposed definition right now, you hope that that is not the final definition.

Mr. KOSKINEN. Well, I hope you wouldn't put those words in my mouth. What I said was I hope that whatever regulation comes out, if there is one, is one that is clear, fair, and easy to administer.

Mr. GRAVES. I thought I heard you say——

Mr. KOSKINEN. That does not take a position on what is out there as draft.

Mr. GRAVES. I thought I heard you say you hope that is not the final definition.

But under that current definition, if it were final, it would mean no faith-based organization can issue a voter guide on public positions that have been taken by candidates to consolidate that information to assist voters. Is that not accurate?

Mr. KOSKINEN. If candidates are mentioned and that is within, as I understand, 30 to 60 days, depending whether it is a primary or an election, that is what the proposed definition would be.

Mr. GRAVES. It would mean that Planned Parenthood wouldn't be able to——

Mr. KOSKINEN. Pardon?

Mr. GRAVES. It would mean organizations such as Planned Parenthood would not be able to issue voter guides, as well, or the national abortion rights could not issue——

Mr. KOSKINEN. Within the ambit of a campaign, within a campaign. That is what the draft would be discussing, and that is what the comments are about. And there will be, ultimately, after the comments are reviewed, there will be a public hearing at which Congressional Members, as well as the public, will be invited to attend.

Mr. GRAVES. Under the current definition, does that mean that the, I guess, let's say the American Legion or the VFW, would they be able to make phone calls to notify voters that want to register to vote, maybe a potential voter, or to notify voters about candidates and their positions on military or defense positions or expansion or defense in general?

Mr. KOSKINEN. Again, the proposed draft up for comment—about which we have 100,000, and we are looking forward to reviewing them—would say that voter registration drives within the context of a campaign would not be allowable.

And the other question that needs to be answered, I would hope everybody would understand, A, it is a question of what the definition is going to be, should it be. And, B, how much of that activity is permitted. Again, it is not proposed that people have no activity. The question is, how much of that activity, as it is defined, can an organization engage in before it jeopardizes its tax-exemption?

Mr. GRAVES. Uh-huh.



Mr. KOSKINEN. And the third important question is to what 501(c) organizations should the regulation, if there is one, apply?

Mr. GRAVES. Okay.

One last question, Mr. Chairman.

How many in the department have been reprimanded or terminated as a result of that latest scandal of scrutiny of various organizations?

Mr. KOSKINEN. That process is still—there is a review board. The leadership from the top on down is all gone at this point, and several of the people are no longer at the IRS.

Mr. GRAVES. Is there a number you can place on that?

Mr. KOSKINEN. There is not a number. I am actually not at liberty to talk about personnel actions. All I can tell you is Danny Werfel appointed a special review board; it reviewed it. The leadership, starting at the ground level all the way up through the Exempt Organizations leadership structure, has all been changed.

Mr. GRAVES. And you feel like it has been, I guess, substantially, it has been justified, all the actions have been—all the reprimands have been taken care of, and you are satisfied with the direction the organization is going now and with the way it has handled the review?

Mr. KOSKINEN. I am satisfied that, as I say, the IG had very good recommendations for training, for guidance, for better review of how organizations, if there are questions, are handled. All of that has gone on. I went to Cincinnati and talked to people to make sure that people are comfortable that, in fact, whatever the issues were before have been solved.

So, again, I think, as I said, it is important, going forward, not waiting. We have six investigations going on. And as I have said, I am looking forward to having at least one or two of them finish sometime soon, so we can see what the actual determination of the facts are. And we will respond appropriately and accordingly, and we will let you know how the response is to that.

But I think people need to understand that going forward from, as I say, this point forward, anyone dealing with the IRS, any taxpayer, should be comfortable that they are going to get treated fairly in the same way anybody else is, no matter what their political affiliation; whatever their organization is; whoever they voted for in any election recently; whether they go to church or don't go to church. If they deal with the IRS, they are going to be treated in the same way everybody else is.

If you get audited—we still, even with limited resources, will do 1,400,000 audits this year, a lot of them just by correspondence. But if you get a letter or you get correspondence, you need to be confident and comfortable that that is because there is something in your return that if it was in somebody else's return would get the same response. That it has nothing to do with who you actually talked to 2 weeks ago, what meeting you went to, what organization you belong to.

[The information follows:]

I have verified that the Shared Responsibility Payment (SRP) established in 5000A to which you referred is payable when the IRS issues a notice and demand for payment. Therefore, an individual is not required to pay the SRP as part of the quarterly estimated tax payments, and the IRS will not impose estimated tax penalties for failure to pay the SRP with estimated taxes. The statute provides special

rules for the assessment and collection of the SRP. A taxpayer who does not timely pay the SRP is not subject to criminal prosecution or penalty for the failure; however, interest accrues on the SRP from the due date for payment specified in the notice.

Mr. GRAVES. Thank you.

Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you.

We will turn to Mr. Amodei.

And, in your absence, we welcomed you, so we welcome you again in your presence.

Mr. AMODEI. Thank you. Thank you, Mr. Chairman. I hope my presence will be better than my absence, but the jury is out on that, so we will go from there.

Thank you, Mr. Commissioner. I want to follow up where Mr. Graves was going. And, first of all, I have looked at your statement, and so I assume you have looked at it. And this is your statement; I am assuming you had help preparing it, but this is your statement that you stand by for purposes of the hearing today.

Mr. KOSKINEN. I wouldn't have submitted it if I weren't going to stand by it.

Mr. AMODEI. Very good.

You have indicated at the bottom of page 1 that the IRS needs to continue to fulfill responsibilities to implement tax-related provisions, major legislation. You have referenced the ACA and the FATCA.

#### 501(C)(4)

I would like to focus for a minute on the genesis of the regulation rewrite, in that, do you know when 501(c)(4) was first put on the books as legislation, generally?

Mr. KOSKINEN. I—

Mr. AMODEI. Let me tell you why I am asking you to help you out. Because we are talking about redoing a regulation now as a result of what happened, I don't believe in Cincinnati, but all the way up the line. And so I am wanting to know how 501(c)(4) worked before this latest round of stuff that started with Cincinnati—

Mr. KOSKINEN. That has been around for a while. The regulation was drafted in the Eisenhower administration in 1959.

Mr. AMODEI. Are you aware of any problems, major problems, where it has been looked at by the IG from Eisenhower forward until what we are talking about now?

Mr. KOSKINEN. I am not.

Mr. AMODEI. Okay. Thank you. I appreciate that. And so, can you—and I know you weren't there, so I am going forward. Congratulations on your timing, by the way. It is excellent.

Mr. KOSKINEN. Some people would say that, actually, the timing isn't so good.

Mr. AMODEI. Well, it is better than others.

Can you tell me the genesis of how it was decided within the IRS, we need to take a look at 501(c)(4) and do new regulations?

And let me tell you why I am asking that, to help you out, is that I get that you want to restore confidence in the IRS and all its pro-

cedures and processes. And good for you. But it is like, there was no, as you indicated in earlier questioning, there was no major tax legislation recently which has aided in your folks' preparation for stuff, so why is 501(c)(4) now on the top of the regulatory heap?

Mr. KOSKINEN. Well, it is on top of the heap now because, A, there was the IG report noting that there were difficulties in the 501(c)(4) determination process. And one of the strong recommendations by the IG in his report and in his subsequent testimony was that the Treasury Department and the IRS should put on their priority plan review and clarification of the requirements. So it was—

Mr. AMODEI. So that was generated internally as a result of IG operations at Department of Treasury?

Mr. KOSKINEN. No, what I am saying is all I know is that there was the issue in the IG report reported and that his recommendation, strong recommendation, was that a regulation be considered as part of the priority process at Treasury and IRS, and that is what has happened. What happened before that, I wasn't there and I don't know.

Mr. AMODEI. Okay. Are you curious as to anything before?

Mr. KOSKINEN. No, at this point, mostly—I have spent 40 years, 20 in the private sector—

Mr. AMODEI. Okay.

Mr. KOSKINEN [continuing].—20 in the public sector—

Mr. AMODEI. And I don't want to cut you off—

Mr. KOSKINEN. No, let me just tell you my—can I just give you my answer?

Mr. AMODEI. You are not curious—you can't on my 5 minutes, I am sorry.

Mr. KOSKINEN. Okay. I will answer in my 5 minutes, then.

Mr. AMODEI. But I endeavor to play by the rules, so—

Mr. KOSKINEN. Okay.

Mr. AMODEI. And I know you are not trying to evade anything there.

Can you tell me what percentage of the IRS's budget is devoted to 501(c)(4) staffing and operations? And let me tell you why I am asking that question. Because you talk about resource challenges and priorities. So what percentage of your operations go to 501(c)(4) administration, enforcement, investigation, whatever?

Mr. KOSKINEN. Well, off the top of my head, I would say it has to be under 1 percent, significantly, in the sense that we have 90,000 employees; only 800 work in the entire Exempt Organizations itself.

Mr. AMODEI. Okay. Fair enough.

Mr. KOSKINEN. So it is a very small number.

Mr. AMODEI. So it is 1 percent of your budget. I appreciate those numbers—

Mr. KOSKINEN. No, I would say it has to be—it is 1 percent or less.

Mr. AMODEI. Okay.

Mr. KOSKINEN. But that is an estimate that I would have to go take a look at. It is clearly, at this point, you know, only 1 percent of the employees working the entire Exempt Organizations, and the

501(c)(4)s are probably 5 percent of that. So you are talking about, I don't know——

Mr. AMODEI. Okay.

Mr. KOSKINEN [continuing].—0.2 percent?

[The information follows:]

The Exempt Organizations function within the Tax Exempt and Government Entities division is responsible for both service and compliance activities related to all tax-exempt organizations, including IRC 501(c)(4) social welfare organizations as well as employee plans and government entities, such as Indian tribal governments. Total FY 2013 expenditures of that function were \$95 million, or 0.85 percent of our overall budget of \$11.2 billion. However, most tax-exempt organizations are 501(c)(3) charitable organizations. Of the approximately 1.6 million tax-exempt organizations active in FY 2013, less than 6 percent were 501(c)(4) social welfare organizations.

Mr. AMODEI. So let me ask you this. I am going to read off about four or five things here, and the context is priorities. You have the ACA that you are working on. You have issues with conferences and spending money. Less than 1 percent, I will do the math on generally what that is of your budget. You have bonuses that are in the news. You have 501(c)(4)s. And then you have taxpayer assistance, which you have devoted a lot of time to.

Number-one priority for regulatory reform out of those is 501(c)(4)?

Mr. KOSKINEN. It is a priority because it has been the issue——

Mr. AMODEI. Is it the number-one priority reform or not out of those five things based on——

Mr. KOSKINEN. I am sorry, you were asking about regulatory reform. We are not reforming ACA; we are just implementing ACA and FATCA. So, in terms of regulatory reform, there is a set of regulations that——

Mr. AMODEI. No, I understand that.

Mr. KOSKINEN. If you are talking about my priorities, I would say that, if we can solve the 501(c)(4) problem, put it behind us, that clearly is one of the five or six priorities I have.

Mr. AMODEI. Well, then, I guess you see my question, where it is less than 1 percent, and you are talking to this committee about our concerns about taxpayer service, our concerns about getting this filing season right, which are all great; the ACA, which happens to be a small project that is floating around. And you have some internal management problems that you have inherited, I appreciate all that, in terms of conferences and bonuses and stuff like that. And it is like, really? A law that has been around for 50 years, and this is what is going on top of the regulatory thing?

My time has expired. Mr. Chairman, thank you.

But I will look forward to interacting in more than a 5-minute context——

Mr. KOSKINEN. I would be delighted to sit down and have a longer discussion with you.

Mr. AMODEI. Great. Look forward to it.

Mr. CRENSHAW. Thank you.

Mr. Yoder.

#### PRIVACY

Mr. YODER. Thank you, Mr. Chairman.

Commissioner, welcome to the Committee. We are pleased to have you come before us today to talk about certainly a variety of issues that are important to constituents at home and many hard-working American taxpayers that interface with the IRS.

You know, last year, in the midst of the outcry over the NSA and the IRS targeting of specifically conservative groups based upon ideology, there was a little-known, I think, breach of public trust that was occurring at the IRS and at other Federal agencies that was brought to light which I think is as stunning or more stunning than some of the other concerns that are constantly raised in the media. The IRS and other Federal agencies admitted that they were reading the emails and electronic correspondence of Americans without a warrant, without respect for Fourth Amendment privacy protections. And the IRS went so far as to be brazen enough to say that Americans do not have a reasonable expectation of privacy when it comes to their email correspondence. That is stunning.

And so, under your leadership, I guess my question would be for you: Is the IRS continuing to read the emails or other electronic correspondence, the private correspondence, of Americans without a warrant in contravention of Fourth Amendment rights? And, secondly, when it was reading those emails, are you aware if it was reading both conservatives' and liberals' private emails equally, or was it also targeting those private readings without warrants just on conservatives, as it was targeted by other portions of the IRS?

Mr. KOSKINEN. This is the first time I have heard that the IRS read anybody's email, so I can't give you any further information. But I will definitely look into that, and I will get back to you with answers to your questions.

Mr. YODER. Well, I appreciate it. And I am sure that if that is occurring, sir, would you, I guess to the Committee, agree to ensure that it no longer occurs at the IRS?

Mr. KOSKINEN. I would be happy to say if we have no authority to do it, then we should not be doing it.

Now, Criminal Investigations does investigate. You know, we have had 4,500 recommendations for indictments last year. So there is a whole enforcement arm of the IRS that, you know, has law enforcement authority, works with Justice Department and States and local governments.

[The information follows:]

In September 2013, the IRS issued an updated press statement explaining our position:

Where the IRS already has an active criminal investigation and seeks to obtain the content of emails from an Internet Service Provider, we obtain a court ordered search warrant. It is not the IRS policy to seek the content of emails from ISPs in civil cases. Respecting taxpayer rights and taxpayer privacy are cornerstone principles for the IRS. Our job is to administer the nation's tax laws, and we do so in a way that follows the law and treats taxpayers with respect. However, to resolve any remaining confusion surrounding this issue, the IRS is reviewing its policy and guidance and will make appropriate updates.

Previously, then Deputy Commissioner for Services and Enforcement Steve Miller issued revised procedures, below:

**Policy Statement 4-120**

**Approved: May 3, 2013**

**(1) Policy Regarding Requests for the Content of Email Communications under the Electronic Communications Privacy Act and the Stored Communications Act.**

(2) The IRS will follow the holding of United States v. Warshak, 631 F.3d 266 (6<sup>th</sup> Cir. 2010), and obtain a search warrant in all cases when seeking from an internet service provider (ISP) the content of email communications stored by the ISP. Accordingly, such information will not be sought from an ISP in any civil administrative proceeding.

(3) Any existing IRS guidance that is not in accord with the foregoing policy statement will be updated.

(4) Signed: Steven T. Miller, Deputy Commissioner for Services and Enforcement

Mr. YODER. Well——

Mr. KOSKINEN. So I don't know how much of this is in their domain. But let me——

Mr. YODER. Well, the IRS, the SEC, and other agencies have argued that they have legal authority under a 1986 law that does not treat electronic correspondence the same way it treats paper correspondence. This is outrageous to a lot of our constituents on both sides of the aisle, and, in fact, many interest groups and entities across the country have spoken out about this.

I have introduced a bill, along with Congressman Graves, my colleague here, and Democratic Members, that has over 175 bipartisan cosponsors to ensure that this practice stops in a variety of Federal agencies.

And so I guess, in your leadership, I would hope that you could ensure that you would head that off at the pass, that the IRS would not be engaged in that practice, and that Americans could trust that their private correspondence is not being read by some IRS agent without a warrant, at least, or following the normal due-process protections that are outlined in the Fourth Amendment of the United States Constitution.

Mr. KOSKINEN. I think it is a very serious matter, and I take it seriously. I will look into it, and I will personally get back to you.

#### FAIR ENFORCEMENT

Mr. YODER. Good. I appreciate that, sir. Thank you for your testimony on that.

The issue has been raised regarding 501(c)(4) groups. That has certainly been discussed in this Committee and many Committees, and it is an issue that many Americans are concerned about. I understand that the IRS is attempting to write regulations that might make the enforcement potentially easier on the IRS.

I think the biggest concern that many of us have is that most Americans didn't have a lot of trust already and now they have very little trust that the IRS is being fair in their enforcement of the law. I have had folks say that they don't want to get involved in campaigns or be associated with any groups because they are afraid they are going to be personally subjected to audits.

Now, I am sure you would say today and I hope that is not happening. Regardless of what rules we write at the IRS, it is not the rules themselves, it is how they are enforced, and it is whether they are enforced fairly and whether we can trust the people, the individuals, in their private moments to do the right thing.

What can you do to ensure that the folks like Lois Lerner and others, that even if the rules are there, that they enforce them fairly? That is the biggest concern for my constituents, not new rules, but that the rules are enforced fairly and——

Mr. KOSKINEN. I agree with you. And that is a situation, as I say, in which the public needs to have to that comfort and confidence. One of the reasons I am spending as much time talking to frontline employees is I am trying to make sure that our IRS culture encourages everybody at all levels of the organization to raise issues and problems and concerns whenever they have them.

Danny Werfel set in motion the beginnings of a program of risk management, and I have told people that everybody has to be a

risk manager in the Agency. And one of the important risks to mitigate is to make sure that we are following the law and we are treating taxpayers fairly. We have a lot of rules to make sure that happens, a lot of review processes, but it does depend on people.

And my concern is to make sure that any employee that is concerned or has a problem or sees anything going on that they feel does not reflect well on the IRS or doesn't treat taxpayers fairly, they need to be comfortable they can raise that directly, either to me or anyone else—

#### ACCOUNTABILITY

Mr. YODER. Well, and to that end, sir, we had Commissioner Shulman come before us and confirm long before this became an issue, we asked him in this Committee, is this happening, would you ever allow this to happen? And he assured us that it couldn't happen, it wouldn't happen.

And so we have heard these assurances before. So just be aware that the trust is not there between Congress and the IRS either, because we have had folks sit in your chair and say, you can trust me, this isn't happening. And so—

Mr. KOSKINEN. And what I would say to that—again, my point earlier was, when I get parachuted into these things, my rule is play the hand you are dealt—

Mr. YODER. Uh-huh?

Mr. KOSKINEN [continuing]. And not spend a lot of time second-guessing decisions.

But as I have told employees, our goal is not to have any mistakes. We have 90,000 employees and complicated tax laws, so some things are not always going to go perfectly. And I have told them that my view of running an organization is, if there is a problem, it is my problem, and we will work on it together. If there is a mistake, it is my mistake, and we will work on it together. And if there is a problem I don't know about, that is my fault, because that means we have not built a culture where issues, problems, difficulties, mistakes get raised through the system.

So my view is I am responsible for and accountable for everything the Agency does. And whenever we make a mistake, we are going to find it, we are going to fix it quickly, and we will be transparent about it. And if I don't know about it, as I say, that is my fault, because I am trying to get the organization comfortable that every individual needs to feel bad news is good news. I can't help a problem, solve the problem, unless I know it exists.

Mr. YODER. I appreciate those statements of personal accountability and responsibility. And I look forward to good results from your leadership, sir.

Thank you.

Mr. CRENSHAW. Thank you.

Ms. Herrera Beutler is recognized.

#### SOCIAL MEDIA

Ms. HERRERA BEUTLER. Thank you, Mr. Chairman.

Thank you, Commissioner, for being here. I have a couple questions, not quite where Mr. Yoder was coming from, but on the issue of social media, Twitter and Facebook.



Last year, the IRS noted it was in the process of reviewing and updating its policies on the use of social media. Quote, “Specifically, the IRS is considering what limitations, if any, should be placed on the use of publicly available”—so it is a little bit different— “social media information in a civil examination or collection action. Any new internal procedures would be made public.”

I guess I was curious—I have two thoughts about that—how you go about deciding who you are going to read up on, if you are going to go that route. You know, is it someone that you are trying to collect information about for a collection action? Or is it that people—you are looking at putting together part of your division that is going to specifically troll online spaces? What is your thought process going in this route?

Mr. KOSKINEN. Our thought process is, when we do examinations, when we send you a letter about something in your return, we deal with you about the return. We do not go and look for whatever your Facebook account might look like. That doesn’t seem to me to be efficient, effective, or appropriate.

When we are in criminal investigations, the Criminal Investigation Division will use all of the information available when they are tracking down people, trying to track down assets. And so there I think it is appropriate for them to use whatever information they have that they need to. But that is when we are tracking down people who, in fact, have violated the law, not paid the taxes that they owe, and are—

Ms. HERRERA BEUTLER. Uh-huh.

Mr. KOSKINEN. One Revenue Agent made a good point to me in Philadelphia. He said, we have to distinguish between the willing to pay who have difficulties, and the unwilling to pay. And the willing to pay who have difficulties haven’t paid, but that is because they have some problem in their family. We ought to deal with them, as we try to, with Installment Agreements or Offers in Compromise.

They are very different than the people who are unwilling to pay, hiding assets, moving them around, storing them offshore. My view is we should chase them to the end of the Earth, and if we can use social media to find the assets or find them, we ought to do that.

Ms. HERRERA BEUTLER. So you are saying you exclusively used Facebook and Twitter for unwilling-to-pay criminal investigations?

Mr. KOSKINEN. That is where I think it is appropriate and important. I don’t know—

Ms. HERRERA BEUTLER. So you are not using Facebook and Twitter for people who are not in criminal investigations?

Mr. KOSKINEN. I do not know about that. I will find out the answer to that.

Ms. HERRERA BEUTLER. I would love the answer to that question.

Mr. KOSKINEN. It is an important question.

Ms. HERRERA BEUTLER. Yeah.

Mr. KOSKINEN. And I will be delighted to find out and share with you that answer.

Ms. HERRERA BEUTLER. Please share it with the Committee. We would all like to know that information.

Mr. KOSKINEN. I would be delighted to share it with the Chairman and everyone.

[The information follows:]

There have been on-going discussions at the IRS about the use of social media, but we are still assessing some issues related to civil cases and discussing next steps. A recent press statement provides additional information on our current position:

**IRS statement, March 2014**

Any suggestions that the IRS is using social media to select individual taxpayers for audit are wrong. The IRS does not select taxpayers for examination based on searches of social media sites.

Taxpayer service is the central thrust of IRS efforts on social media. IRS activities on social media include platforms such as YouTube and Twitter. Our YouTube videos already have been viewed more than 6 million times, and the IRS has more than 80,000 followers on its primary twitter feeds.

Respecting taxpayer rights forms a central part of all of our enforcement efforts.

The IRS is considering what, if any, limitations should be placed on the use of publicly available social media information – information easily accessible to anyone – in support of already existing civil examination or collection actions.

The IRS is currently reviewing and updating, as appropriate, its policies on the use of social media and the internet with the aim of protecting taxpayer privacy and taxpayer rights while administering the nation's tax laws. The IRS strongly emphasizes it is not considering the use of non-public information in civil examination or collection actions.

There are important differences between civil enforcement actions, such as audits or collections, and criminal investigations where law-enforcement work is involved. As Commissioner Koskinen has noted, for criminal investigations it is appropriate to responsibly use available social media information to assist with law-enforcement work. IRS Criminal Investigation works on a variety of important criminal tax matters, and other financial crimes including such things as abusive tax schemes, identity theft, money laundering, terrorist financing and narcotics-trafficking financial crimes.

## FOREIGN ACCOUNT TAX COMPLIANCE ACT

Ms. HERRERA BEUTLER. This is kind of switching gears. I got a letter from a constituent who lives abroad and obviously has some serious concerns about the Foreign Account Tax Compliance Act. And his observation was that a large number of Americans who are voluntarily compliant with this, with our Tax Code—and this law is really detrimentally impacting those folks. Obviously, you are wanting to go after people who are not.

But what he was saying and what he is seeing is that, you know, his bank account has already been closed, he has other accounts that—and, specifically, his bank cited this law as the reason. So he is losing different services, and he is concerned about other accounts he has. And here he is trying to be compliant, he is being compliant. And basically his comment to me was, I am being punished for having an American citizenship. I am following the spirit of the law, not just the letter, and here I am losing services in the countries that I am living that have these accounts because they are citing this law.

What are you doing about—so you talked a little bit before about going after criminal investigations. What are you doing to make this easier on law-abiding citizens, who are trying to comply, who are getting these—you know, we don't want them to have to disavow their American citizenship.

Mr. KOSKINEN. I think that is exactly right. And one of the things that we are looking at as we start to get the information is how to make sure that we impose as little a burden as we can on the people you are talking about who have been compliant for some time.

The problem he is running into isn't from the IRS or from the United States. The problem he is running into is that some banks in some countries are saying, rather than actually determining who is native and who is a foreign-born participant, we are simply going to only deal with resident citizens. And they are saying if you are not a resident citizen, we are not going to provide you services.

That is not a widespread activity because banks obviously are anxious in this global economy to deal with citizens wherever they are coming from. And we are not the only country engaged in this effort. But it is unfortunate wherever a bank in a country X decides that they are only going to deal with their own citizens. You would think it would be pennywise and pound-foolish, because they are missing out on people like your constituent correspondent.

Ms. HERRERA BEUTLER. Can I—

Mr. KOSKINEN. But, anyway, whatever we can do for people who have already been compliant, to try to make sure we don't impose unnecessary burdens on them and that we ameliorate it, to the extent we can, we will. But, obviously, we don't control what foreign banks—

## TAXPAYER COMPLAINTS

Ms. HERRERA BEUTLER. And, really quickly, if someone has a challenge, whether it is this person overseas or whether it is the small-business man I sat next to on my flight over here, who did tell me he feels like he has received retribution for speaking out

politically in the form of a beautiful audit, if someone has that concern or they feel like they have been unfairly targeted, who do they redress their grievances to? Is there a third, independent group? Or do they have to come back to you all and say, hey, wait a minute, you are doing this unfairly?

Mr. KOSKINEN. No, they could feel free to contact me personally, but they have the Taxpayer Advocate, who has been set up independently by a statute. You will hear from her a little later. They can contact her.

The Inspector General does a very good job of pursuing specific issues and complaints. My view is that those are important sources of information. I chaired the Interagency Council of Inspectors General for 3 years while I was at OMB, and I think Inspectors General provide a valuable service and a lot of information. As I told the Chairman earlier, IGs don't create the problem, they actually just discover it for you before it gets bigger and more complicated. And the same with GAO.

Ms. HERRERA BEUTLER. Okay.

Mr. KOSKINEN. So I would think that anytime they feel that way, they should feel comfortable contacting the Taxpayer Advocate.

Because I do think—going back to this issue, if I could take just 30 seconds, we are going to do 1.4 million audits. Some of those people are going to be Republicans; some are going to be Democrats; some are going to be people who never go to church, some are going to be people who go to church regularly. And what is important, and all we can do is continue to emphasize it and actually perform, is for those people to understand they are not getting that letter from the IRS because of who they voted for, where they were last week at a symposium or a meeting; they are getting that letter because there is something in their return that we are asking information about.

Ms. HERRERA BEUTLER. Well, let me—to that point, we are going to have to just say—and I will cut it off here—you are going to have to prove it to us. Because they have received that letter because of political ideology before; it has happened. That is part of what this whole controversy was. So we look forward to you proving it to us as we move forward.

Mr. KOSKINEN. We will—

Ms. HERRERA BEUTLER. With that, I yield back.

Mr. KOSKINEN. It is intolerable for anybody to have it actually happen. And I think it is extremely corrosive for the tax system for people to think it might happen. And they have to understand that we take this seriously. Going back to the priorities, my highest priority is to do whatever I can to restore whatever trust has been lost by the American public in the IRS. We should be viewed as fair. We want people to pay the right amount, not more, not less, and if you deal with us, we are going to deal with you fairly in the same way we would deal with anyone else.

#### 501(C)(4) REGULATION

Mr. CRENSHAW. Thank you very much.

We have some time for another round of questions, if Members have them. Let me start that by asking actually two questions.

One has to do with the 501(c)(4). There has been a lot of discussion about that. And my main concern, as I said in my opening statement, is that it seemed to be premature, in the sense that all these investigations were going on and we didn't have all the information. I think this subcommittee will recall, we put a provision in our markup that said that we wouldn't spend any money that was appropriated under this bill to work on that rule.

That was adopted by the full committee but it didn't make it into the omnibus bill. There was concern that, when we have limited resources, that maybe that is something we could wait until we had all the information. But that didn't happen, and it is going along, and I assume that you don't plan on stopping that any time soon.

So let me just ask you when you anticipate finalizing the draft regulation. For instance, are you going to finalize the draft before the November elections?

Mr. KOSKINEN. I think the chances of it getting finalized before the November election are fairly slim. We have an overwhelming amount of comments to take into consideration. There will be a public hearing; there will be more opportunities for people to provide information to us.

If there is going to be a regulation—and I would say “if.” Nothing guarantees, when you start the process, you end up with a product at the end. If there is going to be a regulation and it has changes in it, it would very likely be republished for more comments.

So, my hope would be that at least some of the six investigations would be done well before we get to anything that looks like finality in whatever regulation might come out. Because I think it is right, we need to know what the facts were in that particular circumstance.

Although, again, the general issue is, how do we provide clarity, not just for the IRS. My concern is, if I were organizing an advocacy operation, I would be appreciative if I had clear guidelines as to how to organize it, but most importantly if I had clear guidelines as to how to operate it. Two or 3 years down the road, the more clarity we can provide to those people as to what you can do and what you can't do, and how much of it you can do without being in jeopardy, it seems to me is very important.

The facts-and-circumstances test and the lack of clarity about how much political activity can you do means that everybody is sitting out there worrying and wondering, well, how does it get measured? Is this going to count on one side of the equation or on the other side of the equation? Am I above if I am 45 percent? Is that now no longer “primarily”? And I just don't think it is helpful for us, but it certainly isn't helpful for people running those organizations.

Mr. CRENSHAW. Well, it is good to hear that you don't think it will be finalized before the elections. I guess it could be, you know, if there is some speed-up process.

But maybe an equally important question is, do you think these draft regulations, have they already produced a chilling effect, as people decide, gee, maybe we better avoid political activities because we don't want to jeopardize our tax-exempt status or have it denied or have it revoked? Might that happen?

Mr. KOSKINEN. I don't know. I haven't seen any studies or surveys about that.

We have tried to emphasize that we have revised and taken all the IG recommendations into consideration. We are providing, we think, appropriate training and oversight for the process. And we are encouraging people to continue to file, if they have an interest in doing that, applications.

In fact, we have a streamlined process that was set up to solve the backlog, which says, if you will simply say that you are not going to spend more than 40 percent of your time on what has been historically viewed as political activity, you can get a streamlined approval, so that you won't even have to worry about the backlog.

Mr. CRENSHAW. And the last question is—you, I think, answered this a little bit—whether you will wrap up all these loose ends and be one final regulation or maybe it might be a series of regulations that are, you know, adopted over the next couple of years. Do you have any judgment about that?

Mr. KOSKINEN. I have no idea. As I said, from my standpoint, I am trying to keep an open mind about the whole thing, see what the comments are. There is a complicated question of, what should the definition, whatever it be, apply to? Should it apply to 501(c)(3)s, 501(c)(5)s, (6)s, (7)s? And I think those are important questions that you can't know an easy answer to.

Again, my instinct is the clearer it is and the more simple and administratable it is, and the fairer to everyone it is, the better off we will all be.

#### FREE FILE

Mr. CRENSHAW. Well, let me ask you one quick happy question, and that is that I found out for the first time this last week that there is a program called Free File that the IRS has in conjunction with a lot of folks that prepare tax services. We had an event in my home district to try to make more people aware of it, because I am not sure everybody is aware. But if you make less than \$58,000 a year, you qualify for the Free File, and you can actually file your tax return for free because of some arrangement the IRS has with this alliance of folks.

They told me that they have to renew that every 5 years with a memorandum of understanding. And so, in an effort to make more and more people aware—they said 70 percent of the taxpayers might be aware, or might be eligible for this Free File. So tell us very quickly if you think that is a good idea and if you plan on signing a new memorandum of agreement to extend it for another 5 years.

Mr. KOSKINEN. It is a good idea. I should take you on the hustings with me, because every time I do a filing season discussion with the press, I try to emphasize that we have this agreement with 14 providers, all the major ones you would think of. You can go on the Free File Web site. A hundred million Americans are eligible. You can pick whichever of the 14 you like, and you can file for free. You don't have to pay anything. You get the same treatment you would if you were actually in one of their offices.

And it is a wonderful partnership, and we do plan to renew it and try to give more visibility to it, because I think taxpayers com-

fortable doing their returns without a provider should take advantage of this. And it is one of the services we are happy to provide.

Mr. CRENSHAW. Well, you are from the IRS, and you are here to help us. So thank you for that.

Mr. Serrano.

#### PRIVACY

Mr. SERRANO. Thank you, Mr. Chairman. I hope you give me a little leeway because I may shock the Committee and the Congress, using a little more time to say that I totally agree with Mr. Yoder. And I know that is shocking to some folks.

I cosponsored his bill. As Ranking Member, I participated in a voice vote on his amendment last year. Because, whether Democratic or Republican, I don't believe that our privacy should be lost. And so, when you hear about government perhaps reading emails, that is unacceptable—unacceptable to us, and it is unacceptable to our democracy.

And I am beginning to hear some people say, well, if you have nothing to hide—it has nothing to do with having anything to hide. It has to do with the Constitution and what this country is known for and the fact that so many other people throughout the world would like to imitate who we are, or who they think we are. And I know who we are, and we shouldn't have that.

Now, that doesn't mean I sign up with those who don't believe in a Federal Government or those who would like to disable government agencies to the point where they can't function. But on this, we agree that Americans have a right to privacy and that it should be something that we protect.

So I think the big headlines tomorrow in one of the Hill papers will be "Serrano and Yoder agree on something," and that is a good sign.

Mr. KOSKINEN. I am happy to be the catalyst for that.

Mr. SERRANO. Yes. Well, someone should tell me where the hustings are. I have no idea if they are near the Bronx or anywhere like that.

#### 501(C)(4)

So let me get this straight. If you have 501(c)(4) status, you are not supposed to engage primarily in activities that are political. If your activities are primarily political, then my understanding is that you can register as a tax-exempt organization under another part of the Tax Code, Section 527.

The problem for some organizations is that if they do this, they will have to disclose who their donors are, as opposed to being registered under a 501(c)(4), where you don't have to disclose who funds you.

So even though these groups could choose to be registered under 527 as a PAC, they don't want to do so because they would have to disclose their donors. Am I correct in that?

Mr. KOSKINEN. That is correct.

Mr. SERRANO. And, not putting you in a spot where you have to try to figure out what happened in the past, was that part of the problem, that people were doing this and, therefore, there had to be some scrutiny, and maybe that scrutiny went overboard?



Mr. KOSKINEN. Well, as I say, I have not spent a lot of time looking backwards because we have six investigations going on. There was an increase in organizations and the flow of money into public discussion and debate and political activities after the Supreme Court case in 2010. So the volume went up, to some extent, it became more visible. Back to the question—you know, for a long time nobody paid much attention because most of these organizations weren't particularly visible.

But I do think that, again, if the process is clear, then people who will meet the criteria ought to be able to make that choice. But a major factor in the choice, I understand, is that if you were a 527, you could spend all your time and money on political activity, but contributions would be visible. If you are a 501(c)(4) social welfare organization, you can only spend a certain percentage of your time. And nobody has quite known what the percentage is, but you have to be primarily a social welfare organization, not engaged in whatever is the definition of "political activity."

#### POLITICAL ACTIVITY

Mr. SERRANO. Now, do you think that—or maybe I missed something. Do your rules define once and for all what is political activity? Do you think we will reach the day when we can define what is political activity?

Mr. KOSKINEN. Well, that is the whole purpose of the draft, and that is the whole purpose of 100,000 comments back to us and the public debate, which I think is an important one, about what should be the definition, and whatever the definition is, how much of that activity should you be allowed to do before you jeopardize your status as a social welfare organization.

And it is not a simple set of questions. It is a complicated issue to figure out how to deal with that in a way that is fair to everybody. I don't think we should be in some way—I think the criticism needs to be considered, and the comments, that we ought to make sure that this applies fairly to people and is not viewed as singling out any particular group of people, which is why you also have to take a look at which sections of the 501(c) statute will, whatever rule, if there is one, comes out, apply to. And so those are important, difficult questions.

As I say, as somebody new to the game, my goal would be, guidance that is clear, fair, and, most importantly, easy to administer. It will be better for the IRS and it will ultimately be better for the groups that meet those standards and are operating. Because they ought not to, 2 or 3 years down the road, have to be continually trying to figure out, well, what does this really mean?

Mr. SERRANO. Right.

Mr. KOSKINEN. And that is my concern about the facts and circumstances test that always have you in a position of trying to judge, well, what are the facts and circumstances? How have they changed? What is somebody going to say? And it just seems to me that is not good for them, and it doesn't do us any good. It gets us involved in a lot of decisions that I think we would be better off not making.

## TRAINING

Mr. SERRANO. One quick last question. I supported including \$200,000 in the Omnibus appropriations bill for training for enforcement employees in the Exempt Organizations unit. Please explain how you will use these funds to prevent the type of problems experienced previously from happening in the future.

Mr. KOSKINEN. Training is important. I know there has been a concern about, and I share that concern, that we train appropriately. The training session that went on was in 2010, and OMB in 2011 and 2012 has made it clear that those sessions aren't going to happen, and training has to be approved at a very high level.

In the particular case of 501(c)(4)s, in response to the IG recommendations, we provide clearer guidance to employees, we have provided more training. One of the recommendations was to provide training before any election, so we will make sure that people understand what is appropriate and not appropriate in terms of reviewing these organizations as we go forward.

And so we are comfortable that, while the standard is still facts and circumstances, which is a little hard to know about, we are comfortable that we have much better training and much better visibility and oversight of this issue. Before—this goes back to 50 years ago—nobody paid a lot of attention to it, which is I think part of the problem.

Mr. SERRANO. Well, I thank you for your testimony. I thank you for appearing here today.

I know you have a very difficult job ahead of you, but if it makes you feel any better, understand that all the years I have been in public office, and it is 40 now, that the IRS has never been a very popular agency. The IRS and the INS were right up there with some folks. So, yes, you have a challenge to bring back the confidence the President wants, but know this is not new. There has been a distrust for many years of the IRS by the public, and this is something we have to keep working on.

So thank you so much for your service.

Mr. KOSKINEN. Thank you.

Mr. CRENSHAW. Thank you.

Mr. Amodei.

## TRANSPARENCY

Mr. AMODEI. Thank you, Mr. Chairman.

And, Mr. Commissioner, thank you for your answers, and I appreciate that.

I guess, I want to just—a couple of things. One is, when we talk about transparency and all that other sort of stuff, any plans to release the Lerner emails to any of the other committees in the near future?

And let me tell you why I am asking that.

Mr. KOSKINEN. No, that is a good question.

Mr. AMODEI. The context of the proposed regulation, the context timing-wise that it comes forward in is something that I don't think anybody in this room can ignore. So, actually, you know, the 50 years may not be very important, but on the heels of what has happened in 501(c)(4)s and then—because if that hadn't have come

to light, the IG probably wouldn't have taken a look into that. And if that hadn't have come to light—you know, so you sit here and you say, going forward—and I respect that—we want to be open, transparent, all that other sort of stuff. But when you say, and, by the way, as part of that, we are going to define political activity—and God bless you for your courage. Sounds about like defining obscenity to me. And the Supreme Court had a hell of a time trying to do that a long time ago. So good luck. I mean, I wish you success.

But I sit there and look at that and say, the timing of when this is going—and we are going to define political activity. With all due respect, that is something the legislative branch probably ought to undertake if it needs to be done, because the regulation will have the effect of subsuming whatever the 50-year-old law is when you define political activity in the executive branch. And we are sitting here trying to go, I agree with it, disagree with it. If that needs to be done, then we ought to have this debate——

Mr. KOSKINEN. Right.

Mr. AMODEI [continuing]. With all due respect.

Mr. KOSKINEN. No, that is right.

Mr. AMODEI. So when are those Lerner emails going to those other meaner committees than this one?

Mr. KOSKINEN. First, I would just correct a slight technicality. What has been in place for 50 years is the regulation. In other words, in 1959, it was an IRS regulation that set in motion the definition that we have today. The law has been there for a long period, longer than that.

But you are exactly right. Even if we end up with a regulation, the Congress always has the authority to either change the statute or overrule the regulation. So it is not as if the IRS and Treasury have carte blanche to do whatever they want.

With regard to the investigations, I am in the process of having further conversations with Chairman Camp of the House Ways and Means Committee about just your question. And we are anxious to provide materials, as I told Chairman Camp when I met with him about a month ago. And he gave me, which I think was very helpful, a list of things that were the last items or the items that they needed to have to get to closure, and we are very anxious to get him all the information he needs to make his decisions.

And so we are working with the Committees. We are working with the Senate Finance Committee, as well, and the other Committees. We have four other Congressional investigations going forward, and——

Mr. AMODEI. And I appreciate that.

Mr. KOSKINEN. And we want to satisfy them that they have the information they need to reach the determination they are making about the determination process.

Mr. AMODEI. But let me tell you why I think it is important. It is not important in terms of who did what to who or who shot the sheriff. It is important in terms of looking at this regulatory proposed action and going, was this a flaw in the regulation or was this something out of the ordinary for purposes—because, I mean, to listen to this today, it is like, “Yeah, we are changing the regulation.” Not you, but I mean generally.

So, anyhow, I think it is important in terms of examining how the existing regulatory body was working before this latest issue came up, not in terms of who got caught doing whatever.

So, with that, I thank you, look forward to visiting with you.

And thank you, Mr. Chairman. And I yield back.

Mr. KOSKINEN. And let me just say a couple things to make sure we have clarity.

The regulation was drafted pursuant to and after the IG report. And the IG report, by my understanding, had been under way when the IRS acknowledged that it, in fact, had been inappropriately highlighting organizations for review in the 501(c)(4) area. But the IG investigation had been going on for some months, and the draft of the regulation was a recommendation from the IG. But you are exactly right, we need to actually provide as much transparency as we can.

My goal on the investigations is to do whatever we can to get all of the investigators the information they need for the determination process. When you start a new investigation saying, well, actually, don't worry about the regulatory process, that is, you know, a different investigation than what we have been dealing with for the last 8 to 10 months. And my only thought about that is we are happy to try to get you information about that, but we can't do a series of investigations all at the same time.

Mr. CRENSHAW. I guess it would be nice to have a rule to just say you can't pick out people based on their political philosophy and bully them and intimidate them and harass them. That would be a pretty clear rule, but—

Mr. KOSKINEN. I think that is the rule.

Mr. CRENSHAW. Well, then I guess that got violated.

Mr. KOSKINEN. And I think there are investigations going on to find out exactly whether they were and how.

Mr. CRENSHAW. Let me recognize Mr. Yoder.

Mr. YODER. Thank you, Mr. Chairman.

And, at this point, I would be happy to yield to Mr. Serrano to say anything else nice he would like to say about me.

I mean, I don't know. If you ran out of time, I would be happy to provide additional time for you.

Mr. SERRANO. Don't push it.

Mr. YODER. All right. Okay.

I want to thank my friend, Mr. Serrano, for his comments. And, as you can see, on that issue, we have strong bipartisan support. I know we have your assurances that we are going to try to fix that.

There are a lot of issues, I think, that we agree on in this Committee and across Congress that don't always get the media headlines. And so it is nice to find more and more of those that we can work together on to fix in this country. And I appreciate Mr. Serrano and other folks on both sides of the aisle working on that and other issues.

And I want to give another one, I think, that maybe we have some bipartisan agreement on. And this comes from a constituent, as I asked, what question should I ask the IRS Commissioner? Right? This could be fun. What would you like me to ask? And I

think this is a very important question and one probably felt by a lot of Americans.

We have talked this morning about the trust deficit that exists between the Internal Revenue Service and Americans, particularly in light of what I will term as much more egregious than maybe we have heard from my colleagues on the other side of the aisle this morning, the abuse of the Code to attack people based on ideology. And we are going to continue to investigate, not only your investigations you have internally, sir, but here within Congress, serious investigations. And people need to be held accountable more so than they have been.

That being said, John, a CPA in my district, makes the point that he is a CPA and the Tax Code is very difficult to navigate. I think we would all agree with that. Four million words, you know, 10,000 pages.

#### TAX PREPARERS

How can the IRS make it easier for qualified preparers and regular taxpayers to efficiently manage their taxes and provide quality service without the threat of onerous penalties for unintentional oversights or misinterpretations or unintentional errors?

Additionally, how can there be less of an adversarial relationship between the professionals and the IRS when dealing with problem taxpayers, as well? Absent new dollars, because it is not just a function of money, how can you operate the IRS in a different way to improve that relationship, which, as you can imagine, for even a CPA or a regular hardworking American who has to pay their taxes, it is a nightmare trying to figure out how to sort through all this. Many of us in this country, I think on both sides of the aisle, believe we need tax reform.

And I would like your comments on that, sir.

Mr. KOSKINEN. Well, as I told the Chairman earlier, I strongly believe in tax simplification and tax reform to make it easier for people to figure out how much they owe. I mean, most Americans, if you could tell them what they owe, they are happy to pay it—or not overly happy, but willing to pay it. But when you impose all sorts of complexity and make it difficult, they get a little less happy.

We have, I think, an important partnership with preparers and those who are qualified to file returns. You know, we are always concerned about unregulated preparers around the periphery, who sometimes engage in fraud, sometimes are uneducated and really don't provide good service. But for people like your constituent, we have a lot of programs trying to reach out to preparers, trying to provide them as much information as we can.

I would hope that as we make the Web site more user-friendly—it used to be clunky in the extreme. And we are spending some of our resources there, because we do think it is important for taxpayer service. But we value the work that preparers do. As I say, they are our outreach to clients. If we can have them comfortable that they understand the intricacies of the Tax Code, it will make it easier for their clients.

One of the things we have is a special tax-preparer line they can call. One of our concerns is even there the resources constraints

have made people wait longer than we'd like. We have heard from preparers that they have to sit on the line longer. And I don't think that is fair to them. I mean, they have businesses to run. If they have to wait half an hour or 45 minutes on the special line, if they have five or six clients, they could waste a significant amount of time.

So all I can say is we value the preparer community. We will continue to reach out to them. The best thing we can do for them is to try to provide them as much information and guidance as we can, and we will keep doing that.

Mr. YODER. And, sir, it is also a function of style. As you know, they take their cues from the person leading the organization. And so, efforts that you can make to ensure that the relationships are less adversarial and more supportive—I think we see this at all levels of the Federal Government, where Americans feel that these Federal agencies are not there to work with them but, rather, to work against them.

Mr. KOSKINEN. Right.

Mr. YODER. And this is a common problem at every agency. And I hope that you will do your best to try to fix those problems at the IRS.

Mr. KOSKINEN. Right. Well, one of the advantages of this tour I am on is I do get to talk to people doing the work.

And in Philadelphia I had a very nice and a very productive meeting with a half a dozen Revenue Agents and Revenue Officers. And that is where I got the willing-to-pay/unwilling-to-pay distinction.

And their point—these are Revenue Officers. You think they are sort of banging on your door to collect—they were saying, we need to make sure that if you are willing to pay and you just have difficulties, that we work with you, that we don't actually make you feel uncomfortable.

And, in fact, their concern is, the biggest problem they have is, a lot of times, people don't respond to notices from the IRS because they are very nervous about it and concerned. And their point was we ought to have a way of making sure people understand that if you are just having trouble paying your taxes, we are going to try to work with you.

The people we don't like are the people who, are consciously trying to avoid paying taxes, trying to hide their assets, moving around the country, engaged in fraud. Those people, you know, we don't have to be very nice to.

But I think the point is well-taken. If there is an honest mistake made, if people didn't understand things, and they are trying to pay, we ought to have a productive working relationship with them.

#### EXPENSES FROM 501(C)(4) INVESTIGATION AND AFFORDABLE CARE ACT

Mr. YODER. And then, if I might, Mr. Chairman, one real quick budgetary question.

Mr. Amodei asked this question earlier in a different way, but I would like to know—and maybe you could just follow up with information for the committee—how many hours and how many dollars have been spent related to the controversy created by the investiga-

tion related to 501(c)(4) groups last year and the reforms or the changes that you are looking at now. And I know you said it was less than 1 percent of your budget. If you could let us know the impact. I know this is prior to your time there, but these things do have an impact on time that could be spent elsewhere.

And how much money has been spent and how much are you needing and requesting related to the enforcement of the Affordable Care Act, and the impact that is having on your agency. I know several years ago and throughout their hearings the IRS has repeatedly asked for hundreds of millions of more dollars to hire more agents to go out to make sure that small businesses and Americans are following the new big government mandates on them regarding this law. And I would like to know the cost to the IRS and where you are finding those resources.

Mr. KOSKINEN. I can answer that question, because it is a question I have been asking. And that is, the 2014 Presidential budget for the IRS proposed \$440 million for the Affordable Care Act. \$330 million of that was for information technology. None of that funding was provided. One of the constraints we have is we have to pay for the IT, particularly, out of the other IT projects we otherwise would have funded, as we go forward.

The \$100 million is primarily for preparing for and dealing with the information issues, designing of the systems, making sure that they work. As you can imagine one of the reasons it is my priority is I am committed that we will, at this time next year, have an effective filing season, which means we will be effectively implementing our responsibilities under the Affordable Care Act. We did that at the front end; the rollout difficulties were not IRS difficulties.

It is a major challenge, and we are finding the funds. It is one of the things that we have to then find ways to fund in other areas of the IRS.

[The information follows:]

There are several possible approaches to calculating the costs associated with responding to these investigations. We have taken a conservative approach. The data below represents employee time and resources directly related to the on-going investigations, as reflected in reporting and coding structures set up in the IRS time/attendance and financial systems to track such costs. We also incurred ancillary support costs in functions that are not reflected in the table below. Examples of such overhead offices are Legislative Affairs, Communications, the Executive Secretariat, and the Human Capital Office. Such indirect costs not specific to these investigations are not included in these figures. We also spent an additional \$6 to \$8 million to optimize existing information technology systems and ensure a stable infrastructure for data reporting.

**Direct Cost of Congressional Investigation as of March 31, 2014**

<b>Category</b>	<b>Cost</b>	<b>Hours</b>	<b># of People</b>
Salaries and Benefits	\$8,496,842	106,894	255
Other, including travel	\$314,454		
<b>Total</b>	<b>\$8,811,296</b>	<b>106,894</b>	<b>255</b>



Mr. YODER. Just a clarification point, Mr. Chairman.

So the amount requested was 440. How much does the IRS spend annually on the implementation of the Affordable Care Act? And how much does it project to spend in the next years?

Mr. KOSKINEN. I can get you that in terms of what we have spent for the last couple years, what we are spending this year, and what our estimate is for next year.

Obviously, one of the issues that is going to happen to us, as I have talked with people about it, is that starting late in the fall, but certainly during filing season next year, because it is a new requirement, we are going to have a lot of inquiries from preparers, as well as taxpayers, if they are eligible for a Premium Tax Credit. And even if they aren't, making sure they are comfortable filling out that return. And we have started that public information campaign this week. We will spend all the rest of this year trying to, again, get preparers and taxpayers comfortable that they understand.

Now, 70 or 80 percent of the taxpayers aren't going to have anything to do with it at all. They are just going to check a box to say, "I have insurance," and they will move on their way. So a big chunk of people won't be affected by it.

But we will be glad to get you and the Committee the information about over the last 2 or 3 years how much have we spent for IT or personnel on Affordable Care, what are we spending this year, and what do we expect the requirements are going to be in the next year or 2.

[The information follows:]

ACA FY 2010 through FY 2013 ACA Spending

	FY 2010 Actual		FY 2011 Actual		FY 2012 Actual		FY 2013 Actual		FY 2014 Estimate	
	\$000's	FTE	\$000's	FTE	\$000's	FTE	\$000's	FTE	\$000's	FTE
Administer New Fees on Drug Manufacturers and Health Insurers	345	1	667	4	1,136	8	1,509	10	2,281	17
Promoting Compliance with Other New Provisions	825	5	11,643	90	8,293	66	9,359	73	8,496	73
Strengthen Oversight of Exempt Hospitals	414	2	4,525	39	4,029	34	3,528	30	3,008	27
Administer Adoption Credit	37	0	2,286	33	2,077	30	241	3	0	0
Support of Implementation & Taxpayer Issues (Counsel & Appeals)	2,360	14	5,008	31	5,174	37	5,066	32	5,228	34
Applications Development/Systems Software/Contracts/Systems Testing & Delivery	15,340	0	131,928	294	257,961	406	248,694	446	344,511	709
Program Management, Business Design and Specifications and Oversight of Data Sharing of Federal Tax Information	123	0	8,366	42	17,909	49	11,819	60	13,366	50
Customer Service/Assist Taxpayers	1,262	9	3,734	44	2,635	34	3,752	47	23,681	310
<b>Total</b>	<b>\$20,706</b>	<b>31</b>	<b>\$168,157</b>	<b>577</b>	<b>\$299,214</b>	<b>684</b>	<b>\$283,967</b>	<b>701</b>	<b>\$400,571</b>	<b>1,220</b>
<b>Cumulative Totals</b>	<b>\$20,706</b>		<b>\$188,863</b>		<b>\$488,077</b>					

Actuals represent fiscal year end status and do not include obligation adjustments processed after the close of the year.

Mr. CRENSHAW. I am sure that when you next appear before us, then there will be a lot of discussion about the dollars that are necessary.

Thank you.

Ms. Herrera Beutler.

#### BONUSES

Ms. HERRERA BEUTLER. I wanted to ask about bonuses really quickly and making sure that bonuses are being given to employees who actually have shown improved performance or goals that they have met.

I don't know if you have seen, have you taken—we put some report language together. Have you taken our guidance within the House report language to ensure that bonuses would be awarded to those who actually show improved employee performance and productivity?

Mr. KOSKINEN. Yes, they are performance awards. The pool is 1 percent of compensation. The performance judgments are made by managers, not by the employees themselves, obviously. And the history is that those awards have gone to about two-thirds of the employees, so a third don't get any. The average size of those awards is about \$1,200, so nobody is making a lot of money.

And if I could, hold her time, if I could respond to the 1 percent, in terms of how did I come to this decision: After the decision was made last year, trying to reach the sequester levels, that performance awards would not be paid to IRS employees, OMB had issued a government-wide edict that 1-percent performance awards could be made.

My predecessor decided that while the contract provided the Bargaining Unit performance awards a pool of 1.75 percent, that we had, we thought, negotiating ability to change that number, and the number went to zero. The Union then, understandably, filed a grievance, an Unfair Labor Practice, and a lawsuit, all of which were pending when I started.

In the course of negotiating a new agreement, which we are in the process of—and I hope sometime in the near future we will have that agreement settled—we have been negotiating about what the performance pool ought to be going forward, and—

Ms. HERRERA BEUTLER. When you say the “performance pool,” what does that mean?

Mr. KOSKINEN. That means that—

Ms. HERRERA BEUTLER. Like, the number of people that are eligible?

Mr. KOSKINEN. The Bargaining Unit is whatever-thousands of employees it is, and you take the salary. And then the question is, what is the performance award pool? It doesn't go to every employee. And—

Ms. HERRERA BEUTLER. So wait a minute. These aren't merit-based?

Mr. KOSKINEN. These are performance awards based on merit. They are determined by the manager. But the size of the pool available for awards was set by the contract at 1.75 percent—

Ms. HERRERA BEUTLER. So that meant—that is a floor. That many will get a performance award?

Mr. KOSKINEN. No. 1.75 percent was the pool. Then each individual Bargaining Unit was evaluated. A judgment was made. And, as I say, about two-thirds of them were eligible for awards, performance awards. The average award was about \$1,200. One-third of them were not eligible because they had not performed, determined by their manager.

And the question is what is the size of the pool or whether there would be a pool at all. The decision then was no pool. We ultimately negotiated a settlement with the Union that they would drop the grievance, the Unfair Labor Practice, and the lawsuit, and we would pay not 1.75 into a pool for performance awards but 1 percent.

In terms of how we are able to do that, we had in our budget, post-sequester, funding for that because as a result of the sequester, we have actually lost another 1,300 people. And on an annualized basis, that provides us part of the revenues we need. We have made more assumptions about cuts in our other overhead expenses of about 4 percent.

And the arrangement with the Union is that we won't pay those awards in the fiscal year the way we have always done it. We pay managers 2 or 3 months after the fiscal year, into the next one. So we are moving the Bargaining Unit awards into the next fiscal year. So this year we are only going to pay one pool award; there won't be two. And that is how it fits within the budget.

So we had——

Ms. HERRERA BEUTLER. So can I, really quickly, reclaiming my time. I——

Mr. KOSKINEN. I was going to give you back 2 minutes.

Ms. HERRERA BEUTLER. What I am interested in understanding is—I think if someone is eligible for an award because they have shown based on their merit and their hard work that they deserve it, I am fine with that.

Mr. KOSKINEN. Good.

Ms. HERRERA BEUTLER. My issue is understanding—you said that the managers make the decision. So I assume, you know, you have issued guidance whereby they can use, you know, some kind of criteria to make this?

Mr. KOSKINEN. Yes, there are——

Ms. HERRERA BEUTLER. And——

Mr. KOSKINEN. There is an agency-wide performance plan run by the Human Capital Office.

Ms. HERRERA BEUTLER. And then there is a follow-up for quality control to make sure that it is not a manager saying—right? So that people have actually met these awards. Because we have seen people receive these performance awards who, for crying out loud, are the subject of investigations.

So I guess I want to make sure that, moving forward, that these awards are appropriately—that that is where my question is.

Mr. KOSKINEN. I have asked that question myself to make sure that, for managers as well as Bargaining Unit employees, when we pay a performance award, we need to be comfortable that the system is actually rewarding performance. Employees know who is performing and who is not. And if you are making awards to people who aren't performing, that is not good for morale either.

So we have a very sophisticated system. And I think your point is well-taken, that we need to—and I have said the same thing—we need to evaluate it to make sure that we are comfortable that this just isn't Lake Wobegon and everybody is above average. That basically we need to be rewarding performance.

And that is my final reason for making this decision. We could do it within the budget. And these are, again, employees who haven't had a pay raise in 4 years, have been subject to a lot of difficulties over the last year. And, ultimately, as I say, 75 percent of our budget is people. Without the people, the work isn't going to get done.

Part of the reason I am out wandering around the country in the middle of the wintertime is to remind those employees, who are dedicated to the mission, that we value their work. They are terrifically dedicated; some of them have been around 20, 25, 30 years, working on this area. And their only concern is, can we get them the resources so they could provide better taxpayer service.

So if, in the course of settling with the Union and saving us the risk of having to pay more in that pool and being able to time it in a different way, I can send a signal to the employees that we value their work, it seemed to me that was appropriate.

Ms. HERRERA BEUTLER. All right.

With that, I yield back.

Mr. CRENSHAW. Anybody have any other questions? I think we are about ready to move into panel two.

So let me just say to you, Commissioner, thank you. I know how busy you are. Thank you for being here today.

And we know what a difficult job you have. I think sometimes we lose sight of the good things that the IRS does, that you do every day under difficult circumstances. Collecting the revenues, talking to folks, answering questions, chasing down the bad guys, all the things that you do every day, we very much appreciate. And we are here to help you do that even better.

So thank you for the time.

This concludes the first panel, and we will have the second panel come along.

Thanks so much.

Mr. KOSKINEN. Thank you, Mr. Chairman.

**Financial Services and General Government Subcommittee**  
**Hearing on Internal Revenue Service Oversight**  
**for Commissioner John Koskinen**

**Questions for the Record Submitted by Chairman Ander Crenshaw**

*Videos*

**Question:** How many videos has the IRS produced or will produce in FY14?

Through March 1, 2014, the IRS has produced or has in production 43 YouTube videos in FY 2014. For comparison, there were 233 video-related productions in FY 2013, which included 77 YouTube videos. These videos are used on three IRS YouTube channels, which includes English, Spanish and American Sign Language. Topics covered by these YouTube videos include an updated "When Will I Get My Refund?" video, self-service options available for taxpayers, identity theft help for taxpayers and tax tips including topics such as simplified home office deductions.

In addition to the YouTube videos, there are 27 other video-related projects that have been completed, are in process or are planned for FY 2014 as of March 1. These include such things as production of taxpayer-focused public service announcements (information on the IRS Free File initiative and qualifications for the Earned Income Tax Credit) and external education seminars (topics for tax professionals from the Nationwide Tax Forums and information on disaster assistance). In addition, these videos include employee training sessions on topics such as annual mandatory training for Unauthorized Access of Tax Information (UNAX) for all IRS employees and professionally focused sessions such as working bankruptcy cases. These internally-focused video efforts reduce the need for more costly in-person meetings and conferences, helping the IRS cut costs by reducing travel and training for meetings and conferences while still meeting high-priority business needs.

The IRS has taken major steps since FY 2013 to improve the oversight of videos and focus efforts on cost-effective projects aimed at improving taxpayer education and employee training.

**Question:** What is the cost of these videos?

Through March 1, the total cost of videos produced was \$83,500. The costs include 43 YouTube videos with a total combined cost of just over \$13,500. These videos have been viewed 1.6 million times through March 1. The remaining \$70,000 paid for 27 training and outreach videos. This cost includes various technical production components including captioning, which is required to be compliant with Section 508 of the Rehabilitation Act. The Act requires the video is accessible to people with disabilities. These costs also include work on the Free File program which is intended for use over several years.

**Question:** Does the IRS contract out the production of videos?

Most of these video efforts have been done in-house by IRS employees, with limited assistance on some videos. Since the start of FY 2013, we have taken significant steps to reduce the use of outside contractors, and the Service-wide Video Editorial Board has been a critical part of that effort. Use of outside contractors is very limited. For example, YouTube videos feature IRS employees – not actors. Much of our production work is done by employees. For some videos, there are outside costs where we use contractors on a limited basis, which includes such things as closed and open captioning and some editing for projects in English, Spanish and American Sign Language.

### ***Root Cause of Targeting***

You have a background as someone who fixes problems and organizations.

**Question:** Before making changes to a process or organization, do you think it is important to understand the root cause and history of the problem?

Yes, before changing a process or organization, it is important to understand how the process or organization operated, including what difficulties and complications it experienced.

**Question:** Do you think the House, Senate, and Department of Justice investigations will provide any useful information on how the targeting was allowed to occur and continue for several years?

I look forward to reviewing the findings of all the investigations. We recently informed various Congressional Committees that we believe we have completed our production to the Ways and Means and Finance Committees of all documents that we have identified as relating to the processing and review of applications for tax-exempt status as described in the May 2013 TIGTA report. We are continuing to cooperate with the committees receiving redacted documents, and we will continue redacting and providing documents until that process is completed. Once we have the resulting reports from these investigations, we can then take further corrective action where necessary. The conclusions and recommendations in these reports will be a critically important step in the process of learning from, addressing and moving beyond any problems or concerns that may be identified in the reports.

**Question:** Would waiting for the findings of these investigations before changing the tax exempt rules be a good idea?

It is important to note that TIGTA, the National Taxpayer Advocate and members of Congress all recommended that Treasury and the IRS consider issuing new guidance on

this area. Our Notice of Proposed Rulemaking is consistent with those recommendations. I believe it is extremely important to make this area of regulation as clear as possible, not only because it will help guide the IRS in proper enforcement, but because it will also give a better roadmap to applicants and help those that already have section 501(c)(4) status understand the applicable standards and properly administer their organizations.

### ***Public Hearings***

**Question:** How many public hearings will the IRS hold on the draft 501(c)(4) regulation?

**Question:** Will any of these hearings be held outside of Washington, DC?

**Question:** Will you personally attend these hearings?

**Question:** Will you commit to hold as many hearings as it takes until everyone who wishes to speak is heard?

We have not yet made these decisions. Our goal is to fashion a rule that is fair, straightforward, and clear. We are in the process of reviewing the more than 150,000 comments that we have received, which set a new record. We are committed to holding a public hearing before finalizing any regulation on this topic. As I have said previously, in all likelihood we will re-propose a redefined rule and ask for more comment.

### ***Reporting Requirements***

In addition to delaying the employer mandate, the Administration also delayed the reporting requirements for insurers and employers, including State and local governments.

**Question:** How will the IRS know who is eligible for a premium tax credit in 2014 if the IRS does not have information about who was offered employer-sponsored plans, the affordability of those plans, and the value of those plans?

Beginning with 2014 tax returns filed in 2015, individuals will be eligible to claim the premium tax credit and will be required to reconcile any advance payments of the premium tax credit already paid to their insurance companies on their behalf. The IRS will be required to promptly process accurate returns while also efficiently identifying and stopping any erroneous claims.

Although access to information applicable large employers will file under section 6056 and providers of minimum essential coverage will file under section 6055 in filing season 2016 and later will enhance the IRS' enforcement capabilities, it must be remembered that Marketplaces will be transmitting over secure, encrypted channels to the IRS enrollment information for individuals purchasing coverage through those Marketplaces. This transactional information will include the fact and cost of coverage, and information



on any advance payments of the premium tax credit made during the coverage year to the taxpayer's insurance company on their behalf.

Marketplaces will be providing the IRS with this transactional data prior to the beginning of the 2015 tax filing season. Having this pre-positioned transactional data will allow the IRS to efficiently check for many of the basic qualification and computational elements of the premium tax credit. While the IRS does not share publicly all of the tools and techniques used for detecting non-compliance, it is important to note that as the tax returns are processed, for example, the IRS will be able to determine whether:

- There is a record of anyone on the return having enrolled at a Marketplace (a basic requirement to claim the credit);
- The return passes a basic check against a Marketplace record, meaning there is record coverage was obtained from the Marketplace, but the return does not acknowledge that advance payments have already been paid directly to the insurance company and need to be netted against the credit calculation before a refund can be due; and
- The return reports inaccurately high premium costs or inaccurately low advance payments as compared to the Marketplace data.

Of course, additional eligibility and accuracy issues will also be checked using other ACA-specific information and by applying the same new and enhanced techniques we apply to all returns to detect non-compliance.

**Question:** When do you expect final regulations for insurer and employer reporting requirements to be completed?

The final regulations were released on March 5, 2014, and appeared in the March 10, 2014 Federal Register. 79 Fed. Reg. 13220-13252.

### ***Bonuses***

**Question:** Please explain how and why bonuses for the IRS are an appropriate expense given your concern that the IRS has insufficient funding.

My decision to pay awards at significantly reduced funding levels was not made lightly. Following my recent visits with frontline employees and managerial employees during which I have observed first-hand their hard work and accomplishments, I am convinced that reinstating awards in FY 2014 was the correct decision. Providing these awards allows us to recognize our high-performing employees who do impressive work on a wide range of efforts across the IRS, from taxpayer service and tax enforcement to Information Technology and other critical support functions. It also allowed us to enter into negotiations and mediation with the National Treasury Employees Union to reduce the awards to 1 percent of the total annual bargaining unit salaries and avoid protracted litigation. Losing litigation could have resulted in the payment of a full 1.75 percent of

total annual bargaining unit salaries as well as attorneys' fees and interest. I am convinced that reinstating performance awards in FY 2014 was the correct decision.

Employees are accomplishing this work with FY 2014 funding levels that are nearly \$1 billion below what the agency received four years ago. At the same time, the taxpayer population has increased along with our responsibilities to implement tax law changes from the Congress. We started FY 2014 with 2,500 fewer permanent staff compared to the previous year and close to 11,000 fewer permanent staff than four years ago. Our employees continue to achieve much more than anyone could expect given the funding provided and the increasing workload.

In addition, we take tax compliance seriously, and hold employees to the highest standards on tax issues. In fact, we have a disciplinary program for employees with federal tax compliance issues. Our workforce recognizes the importance of filing returns and paying taxes timely, and historically, more than 99 percent of our employees do so each year. This rate of compliance is significantly better than the federal government overall, and is higher than the general population.

**Question:** How many more phone calls could the IRS answer if Acting Commissioner Werfel's decision against paying bonuses had been upheld?

While the funds for performance awards may have allowed the IRS to hire more employees, following my visits with employees, it has continued to be clear to me this is money best spent on performance awards for our existing employees. The performance award payouts are in recognition of good work done in very trying circumstances. While the IRS portfolio of responsibilities has expanded, employees continue to support our service and enforcement responsibilities by doing more with less. Again, it is important to note that the settlement agreement helped us to resolve legal issues and protracted litigation. I continue to believe that this investment in our employees will directly benefit taxpayers and the tax system by helping to improve employee morale and rewarding high performance.

### *Premium Tax Credits*

**Question:** When did the IRS begin paying premium tax credits?

Premium tax credits will be claimed and advance payments of the premium tax credit will be reconciled for the first time on taxpayers' 2014 federal income tax returns filed with the IRS in 2015. Accordingly, premium tax credits have not yet been processed by the IRS.

Under section 1411 of the Affordable Care Act, a Marketplace makes an advance determination of premium tax credit eligibility for individuals enrolling in coverage through the Marketplace and seeking financial assistance. Using information available at the time of enrollment, the Marketplace determines (1) whether the individual meets the

income and other requirements for advance credit payments, and (2) the amount of the advance payments. The Department of Health and Human Services (HHS) is the lead agency on defining the structure and operations of the Marketplaces. Therefore, to the extent your question concerns advance payments of the premium tax credits, we refer you to HHS.

**Question:** How much has been paid to date?

As noted above, premium tax credits will be claimed and advance payments of the premium tax credit reconciled for the first time on taxpayers' 2014 federal income tax returns filed with the IRS in 2015.

To the extent your question concerns the amount of advance payment of the premium tax credit paid to insurance companies to-date, we refer you to HHS. However, it is noted that monthly and current fiscal year to date information regarding outlays of advance payments of the premium tax credit and cost sharing reductions can be found in the Monthly Treasury Statement, available at <https://www.fms.treas.gov/mts/index.html>.

**Question:** How much will be paid by the end of fiscal year 2014?

As noted above, premium tax credits will be claimed and advance payments of the premium tax credit reconciled for the first time on taxpayers' 2014 federal income tax returns filed with the IRS in 2015. To the extent your question concerns the amount of advance payment of the premium tax credit paid to insurance companies to-date, we refer you to HHS.

**Question:** How many households have the Federal and State healthcare exchanges reported to IRS as qualified for a premium tax credit to date?

As noted above, premium tax credits will be claimed and advance payments of the premium tax credit reconciled for the first time on taxpayers' 2014 federal income tax returns filed with the IRS in 2015. Accordingly, we do not yet know how many taxpayers will claim the premium tax credit.

**Question:** How many of those households elected to receive the advance premium tax credit?

We refer you to the HHS, the lead agency on defining the structure and operations of the Marketplace.

**Question:** How many income and family size changes have been reported to the IRS to date?

Individuals do not report changes in income and family size to the IRS. The actual premium tax credit for which a taxpayer is entitled will differ from the advance payment of the premium tax credit determined by the Marketplace if family size and household income as estimated at the time of enrollment are different from the family size and

household income reported on the federal income tax return. This may result in the taxpayer having to pay back advance payments with their tax return. Accordingly, individuals should timely report changes in income and family size to the Marketplace so that the amount of advance payments of the premium tax credit can be adjusted, if necessary.

**Question:** What happens when an insurer receives an advance premium tax credit for someone who, according to the insurer's records, is not a customer of theirs? How does the IRS collect the funds from the insurer?

We refer you to the HHS, the lead agency on defining the structure and operations of the Marketplace.

**Question:** What happens when an insurer does not receive an advance premium tax credit for someone who is eligible for the credit and enrolled in an exchange plan? How does the IRS assist that person?

We refer you to the Department of Health and Human Services, the lead agency on defining the structure and operations of the Marketplaces.

### ***Free File***

**Question:** Does the IRS intend to renew the Memorandum of Understanding with the Free File Alliance in order to continue the Free File program for an additional five years?

Yes, on May 21 the IRS and Free File Incorporated (formerly known as the Free File Alliance) announced the extension of the current Agreement and Memorandum of Understanding for one year through October 2015. The extension agreement includes specific language that a full renegotiation of the five year Agreement/MOU will be initiated and completed prior to the expiration of the extension.

**Question:** Could you give an update on the current status on the renewal negotiations with the Free File Alliance?

The current Free File Agreement expires on October 30, 2014. On February 7, 2014, IRS met with representatives of Free File Incorporated (FFI, formerly known as the Free File Alliance) to discuss and reach agreement on a one-year extension. The extension document is currently going through the IRS review and signature process so it can be forwarded to FFI for their final review and signature.

**Question:** Could you please provide a timeline for holding Free File meetings, circulating a draft, and concluding negotiations?

Beyond the one-year extension in process, it is the intention of IRS leadership to initiate broader negotiations for the five-year agreement by June 2014, with a goal to conclude those negotiations by December 2014.

### *Affordable Care Act*

**Question:** Please provide a table summarizing the IRS's FY 2013 obligations and FTE for implementing the Affordable Care Act according to the appropriations account and activity.

The table below provides FY 2013 Affordable Care Act obligations and FTE by activity and account.

ACA FY 2013 Actuals by Appropriation

	Taxpayer Services		Enforcement		Operations Support		Total	
	\$000's	FTE	\$000's	FTE	\$000's	FTE	\$000's	FTE
Administer New Fees on Drug Manufacturers and Health Insurers	-	0	1,509	10	-	0	1,509	10
Promoting Compliance with Other New Provisions	211	1	9,038	71	112	1	9,369	73
Strengthen Oversight of Exempt Hospitals	34	0	3,464	30	29	0	3,528	30
Administer Adoption Credit	-	0	241	3	-	0	241	3
Support of Implementation & Taxpayer Issues (Counsel, Appeals, Taxpayer Advocates)	46	0	5,020	32	-	0	5,066	32
Applications Development Systems Software/Contract Systems Testing & Delivery	-	0	-	0	243,694	446	243,694	446
Program Management, Business Design and Specifications and Oversight of Data Sharing of Federal Tax Information	225	2	38	0	11,556	56	11,819	60
Customer Service Assist Taxpayers	3,752	47	-	0	-	0	3,752	47
<b>Total</b>	<b>\$4,268</b>	<b>50</b>	<b>\$19,308</b>	<b>146</b>	<b>\$250,391</b>	<b>505</b>	<b>\$263,967</b>	<b>701</b>

### *Site Visits*

**Question:** At the hearing, you stated a goal to visit the largest IRS campuses and field offices. Please provide the city and date of the visits that you have already made and remaining cities and estimated dates of the visits that you planning to make. Please indicate which locations are campuses and which are field offices.

1/09 – Cincinnati (Campus and Field Office Visit).

1/10 – Philadelphia (Campus Visit)

1/23 – Memphis (Campus and Computing Center Visit)

1/24 – Atlanta (Campus and Field Office Visit)  
1/30 – Martinsburg (Computing Center Visit)  
1/31 – Baltimore (Field Office Visit)  
2/6 – Dallas (Field Office Visit)  
2/7 – Jacksonville (Field Office Visit)  
2/19 – St. Louis (Field Office Visit)  
2/20 – Kansas City (Campus Visit)  
2/27 – Fresno (Campus Visit)  
2/28 – Oakland (Field Office Visit)  
3/5 – Houston (Field Office Visit)  
3/6 – Austin (Campus and Field Office Visit)  
3/19 – Portland (Field Office Visit)  
3/20 – Seattle (Field Office Visit)  
3/27 – Brookhaven (Campus Visit)  
3/28 – New York City (Field Office Visit)  
4/3 – Detroit (Computing Center visit)  
4/4 – Chicago (Field Office Visit)  
4/9 – DC (77 K Street and 1111 Constitution Avenue) (Field Office Visit)  
4/10 – Andover, MA (Campus Visit)  
4/11 – Boston, MA (Field Office Visit)  
4/17 – Ogden, UT (Campus Visit)  
4/18 – Denver, CO (Field Office Visit)  
4/24 – DC (Mint Building) and New Carrollton, MD (Field Office Visit)

## **Questions for the Record Submitted by Congressman Kevin Yoder**

### ***Dividends***

The Internal Revenue Service (the “IRS”) recently re-proposed a rule under Section 871(m) entitled, “Dividend Equivalents from Sources within the United States.” As you know, many market participants are expressing concern with this rule, because it is capturing a wide variety of instruments that have nothing to do with trying to avoid withholding taxes.

**Question:** Given the industry concern that a delta .70 test (the measurement of how much the price of the derivative instrument changes based on the change in price of the underlying security) is far removed from a transaction that is economically similar to buying the underlying security, can you explain why you have not decided to make the threshold closer to delta 1.0, which market participants agree is a more appropriate threshold for economic equivalence, or similarity?

Under section 871(m), any notional principal contract may provide for a dividend equivalent payment unless Treasury identifies, through regulations, that a contract is “of a type which does not have the potential for tax avoidance.” Section 871(m) further provides that a dividend equivalent includes any “substantially similar payment.” On December 5, 2013, a withdrawal of notice of proposed rulemaking, notice of proposed rulemaking and notice of public hearing were published in the Federal Register at 78 FR 73128 (2013) (the “2013 proposed regulations”). The 2013 proposed regulations provide for the delta 0.70 test. The delta .70 test in the proposed regulations was selected after discussions with participants in the derivatives and options markets. As a general matter, an option with a delta of .70 is substantially in-the-money and has approximately a 70 percent probability of exercise. Moreover, the price of an option includes estimated dividends, as is true of the price of a futures or forward contract, which means that an in-the-money option also has the potential for avoidance of U.S. withholding tax.

At this time, no final decision regarding the delta test has been made. The deadline for submission of comments relating to the 2013 proposed regulations was March 5, 2014. A public hearing was scheduled for April 11, 2014, but the event was cancelled because no one filed a request to speak. Prior to finalizing the 2013 proposed regulations, the Treasury Department and the IRS will evaluate all comments received, including industry suggestions regarding the appropriate level for the delta test.

### ***501(c)(4)s***

On February 5, 2014, you testified before the House Ways & Means Committee about the proposed rule issued by the IRS on November 29, 2014 regarding 501(c)(4) tax exempt organizations. At that hearing, you said that you would review and weigh in on the regulations “to the extent I have any control over it.” Later, you were quoted in Politico on February 18, 2014 as stating, “I don’t control the process totally.”

By law, you do have control over the process. The regulation I'm referring to is 26 CFR 601.601. It says, and I quote, "Regulations and Treasury decisions are prepared in the Office of the Chief Counsel." That's the IRS Chief Counsel's Office. Your Chief Counsel. He reports to you. The regulation goes on, "After approval by the Commissioner," – that's you – "regulations and Treasury decisions are forwarded to the Secretary or his delegate for further consideration and final approval."

**Question:** Do you believe that this regulation applies to you?

Section 601.601 is part of the Statement of Procedural Rules (SPR), which applies only to the operations of the Internal Revenue Service. As recognized under long-standing case law, the SPR are directory and not mandatory, and do not have the force and effect of law. Instead, the authority of the Secretary to issue regulations interpreting the Internal Revenue Code has been delegated to the Assistant Secretary (Tax Policy) in Treasury Order 111-01. Treasury Order 111-01 provides that the Assistant Secretary (Tax Policy) is "exclusively authorized to make the final determination of the Treasury Department's position with respect to issues of tax policy arising in connection with regulations ...." Treasury Order 111-01 also describes the roles of the IRS Commissioner and the General Counsel (including the IRS Chief Counsel) in issuing IRC regulations: the Assistant Secretary (Tax Policy) "... shall solicit and give due regard to the views of the Commissioner of Internal Revenue respecting the operational and enforcement consequences of any such determination and to the views of the General Counsel (including the Chief Counsel of the Internal Revenue Service) as to the legal aspects of any issue." Accordingly, the promulgation of regulations is a collaborative process that takes into account the views of the Assistant Secretary (Tax Policy), the IRS Chief Counsel, and the Commissioner of Internal Revenue. As a result, the Commissioner does not control the regulation process.

**Question:** Are you or your delegates required to approve IRS regulations before they go to the Treasury Department for final approval?

As a practical matter, regulations issued under the Internal Revenue Code are jointly issued by Treasury and the IRS. Among other things, under IRS Delegation Order 1-23, the IRS Commissioner has delegated approval authority over IRC regulations to the Deputy Commissioners. IRC regulations then are forwarded for approval to the Assistant Secretary (Tax Policy) after approval by the Commissioner.

**Question:** Could one of your subordinates approve a regulation over your objection?

No.

**Question:** Are there any other people, other than you and the IRS staff who report to you, with decision making authority or influence over the IRS' rulemaking?



During the course of drafting Treasury regulations and the approval process for those regulations, the views of all interested functions of the IRS, the IRS Office of Chief Counsel, and the Treasury Department on both the legal and operational/administrative aspects of the regulation are routinely solicited and considered. When appropriate, views and opinions of other government departments and agencies are solicited and considered. Members of Congress and their staffs often express views and opinions on matters that are addressed in Treasury regulations as part of the notice and comment process, and those views and opinions are considered with the other comments received. Finally, public comments are solicited and considered in publishing the annual Priority Guidance Plan and its updates, and public comments are solicited and considered on proposed regulations during the rule-making process.

**Question:** Does the Treasury Secretary, the Treasury General Counsel, or political appointees in their offices have any role in deciding the position of the IRS with respect to the 501(c)(4) rulemaking? Will they be consulted in any way by you or anyone on the IRS staff before the IRS makes a decision regarding whether a final rule should be issued and regarding the content of any final rule?

See the prior answer.

**Question:** How will the 501(c)(4) rulemaking be protected against political influence?

The rulemaking process followed by the Treasury and the IRS is designed to be transparent, which includes consideration of any public comments and the conduct of a public hearing before any rule is finalized. Any regulation that finalizes the proposed regulation will discuss the reasons for accepting or rejecting public comments in the preamble to the final regulation. Under the Congressional Review Act, Congress has the authority to override a final regulation, and Congress has the inherent ability to pass legislation that addresses the subject matter of any final regulation. An affected taxpayer also has an ability to challenge the validity of a final regulation in court when the final regulation is applied to their tax situation.

**Question:** Have you had any discussions about the 501(c)(4) rule, its formulation or its content with Senator Levin or his staff?

I have not discussed with Senator Levin or his staff the formulation or content of the §501(c)(4) regulations. However, the Treasury and the IRS have received numerous comments and suggestions from Senators and Members of Congress and their staffs addressing section 501(c)(4) and the regulations thereunder, including from Senator Levin and his staff. A continuing and open dialogue with elected representatives and their staffs on all issues affecting the administration of the federal tax laws is an important part of administering those laws.

**Questions for the Record Submitted by Congresswoman Jaime Herrera-Beutler**

***Social Media***

**Question:** Does the Internal Revenue Service currently gather information from taxpayers' social media use or other online activity?

The IRS does not randomly monitor individual taxpayer social media activity. Suggestions that the IRS is using social media to select individual taxpayers for audit are wrong. The IRS does not select taxpayers for examination based on searches of social media sites.

Taxpayer service is the focal point of IRS efforts on social media. IRS activities on social media include platforms such as YouTube and Twitter, where we share information with taxpayers. Our YouTube videos already have been viewed more than 6 million times, and the IRS has more than 80,000 followers on its primary twitter feeds.

Social media also assists in alerting us to early and emerging system issues that larger groups of taxpayers may be encountering during the filing season. These sites can offer helpful insight to IRS communications and taxpayer service personnel to identify emerging problems, helping us identify solutions quickly and share information back to taxpayers and tax professionals as well as social media sites. An example can be seen in last year's education credits, when taxpayers commenting in social media alerted us to an emerging problem involving Form 8863, where boxes on the form were not being checked properly by some claiming the credits. The IRS emphasizes that its use of social media is focused on identifying and solving wider systemic issues or questions affecting larger blocks of taxpayers -- not tracking or monitoring individual taxpayers.

**Question:** Do you believe that the IRS should be able to access information from taxpayers' social media account, such as Facebook and Twitter, or other online activity to mine additional information about taxpayer? In what scenarios do you believe it would be acceptable to look at a taxpayers Facebook account?

The IRS is in the process of reviewing and updating its policies on the use of social media. Specifically, the IRS is considering what limitations, if any, should be placed on the use of publicly-available social media information in a civil examination or collection action. Any new internal procedures would be made public.

**Question:** Has the IRS has completed its review? What's the updated policy for IRS employees' ability to search for a taxpayer's social media accounts?

Respecting taxpayer rights forms a central part of all of our enforcement efforts.

Social media is a rapidly changing and developing area of information. The IRS believes there are components of social media that are critical to helping meet the needs of tax

administration going forward, particularly in the arena of taxpayer service. Our efforts in social media have been largely focused on information sharing with taxpayers through channels such as YouTube and Twitter.

The issue is complex when it comes to tax enforcement, and there are important distinctions between our work in criminal law-enforcement investigations and in civil cases, which include things such as audits (examinations) and collection activity.

For civil side actions, such as examinations, we don't use social media to select people for audit. Audit selection is based on what taxpayers include on the tax return and, in some instances, through information we receive from third parties. What happens after a taxpayer is selected for a civil audit or civil collection action is the area that we are taking a look at.

The IRS is considering what, if any, limitations should be placed on the use of publicly available social media information – information easily accessible to anyone -- in support of already existing civil examination or collection actions. The IRS is currently reviewing and updating, as appropriate, its policies on the use of social media and the internet with the aim of protecting taxpayer privacy and taxpayer rights while administering the nation's tax laws. The IRS strongly emphasizes it is not considering the use of non-public social media information in civil examination or collection actions.

There are important differences between civil enforcement actions, such as audits or collections, and criminal investigations where law-enforcement work is involved. For criminal investigations, it is appropriate to responsibly use available social media information to assist with law-enforcement work. IRS Criminal Investigation works on a variety of important criminal tax matters, and other financial crimes including such things as abusive tax schemes, identity theft, money laundering, terrorist financing and narcotics-trafficking financial crimes.

### ***Bonuses***

While employee performance awards are aimed to incentivize employees for the merits of their hard work, I find it extremely disturbing the IRS rewarded employees for clearly egregious behavior such as targeting conservative groups. I supported the provisions to require extensive reporting on training and bonuses for IRS employees.

**Question:** Have you taken the guidance within the House Financial Services and General Government Subcommittee Report language to work with the Office of Personnel Management and determine bonuses would be awarded to those that actually improve employee performance and productivity?

The IRS performance management systems were designed to meet all federal laws and regulations including the language of the Subcommittee's report. Granting monetary performance awards is one of the several effective ways to recognize and reward employee performance.

*FATCA*

I received a letter from a constituent living abroad. He has serious concerns about the Foreign Account Tax Compliance Act. This law is adversely affecting many American citizens who are losing business with financial institutions overseas.

A large majority of Americans are voluntarily compliant with our tax code and this law has detrimentally affected many compliant taxpayers. My constituent has already seen his retirement savings account closed by his bank. His bank cited FATCA as the reason.

He has other accounts as well but is understandably concerned those account could also be closed or he can lose other banking services. He said "US citizens are being driven to renounce their citizenship as this is the only way to remain where they are and not be subject to the denial of services due to holding US citizenship. I fear that if changes to FATCA are not made, I may be driven to follow suit."

**Question:** It should be incumbent upon you to ensure Americans are not detrimentally affected by the implementation of FATCA. How can you remedy these problems that many Americans like my constituent are facing?

FATCA was enacted by Congress in 2010 and goes into full effect this year. The law applies to all foreign financial institutions, regardless of whether the financial institution maintains accounts for U.S. persons. Nothing under FATCA prohibits foreign financial institutions from maintaining accounts for U.S. citizens; rather, the law requires that the financial institution undertake due diligence procedures to identify U.S. account holders and to report information on any U.S. accounts to the IRS. Although not having U.S. accounts will mean that no reporting will be required, turning away U.S. account holders will not allow the financial institution to avoid complying with many of the general requirements of FATCA.

We take very seriously concerns about the availability of banking or other financial services to U.S. citizens living abroad. While it is not possible for the Treasury Department or the IRS to require foreign financial institutions to make accounts available to U.S. citizens, Treasury has done what can be done in the final FATCA regulations, and in both model intergovernmental agreements on FATCA, by making certain benefits available to low-risk local financial institutions conditional on the institution not having practices that discriminate against opening or maintaining accounts for U.S. citizens.

We also point out that the G-20 Finance Ministers recently endorsed a "Common Reporting Standard" representing a multilateralization of the FATCA requirements. Thus, we can expect that, in the near future, financial institutions around the world will be performing due diligence and reporting with respect to accounts of residents of many countries. We anticipate, therefore, that financial institutions will no longer have any reason to single out U.S. account holders and that this phenomenon will subside.

## PANEL #2—IRS OVERSIGHT

Mr. CRENSHAW. Well, let me welcome our second panel today. I want to thank you for your patience and for being with us today. We appreciate both your time and your expertise.

I am pleased to welcome back the Treasury Inspector General for Tax Administration, Russell George, to share his observations of compliance and recommendations about the efficiency of the IRS. Since the IRS is the largest Treasury bureau, then TIGTA is accordingly the largest of the three Treasury inspector generals. And to whom much is given, much is expected.

We are relying on your office and your counsel to help us assess and understand the IRS's management and use of taxpayers' funds. So welcome back, Inspector George.

I am also pleased to welcome back Nina Olson, the National Taxpayer Advocate.

This is your first appearance before the subcommittee since 2007. I am hoping today we can hear from you about services you provide to the taxpayers, what you are doing to help those taxpayers who may have been victims of tax fraud and abuse, how the IRS can make the most of its funding. So welcome, Ms. Olson.

I appreciate the service of both of you all and look forward to your testimony. But first let me yield to Mr. Serrano, the ranking member, for any opening statement he would like to make.

Mr. SERRANO. Well, I also want to welcome you both here.

We just had a very interesting conversation with the Commissioner, and I would be interested to hear, Mr. George, what your recommendations are and how things are falling into place or not, and of course from you, Ms. Olson, on how we can better serve the public and maybe bring down some of that fear everybody has of the IRS.

And so we thank you, and we look forward to your testimony.

Mr. CRENSHAW. Thank you.

Let me start by asking both of you all a question. Oh, I am sorry. I would like to ask you to make your opening statements. I got carried away. Mr. Serrano was so brief, I just got so confused.

But, please, take your time and tell us what is on your mind. Mr. George, will you begin?

Mr. GEORGE. Thank you, Chairman Crenshaw. Ranking Member Serrano, Members of the subcommittee, thank you for the opportunity to discuss significant challenges currently facing the Internal Revenue Service.

Let me start with the topic of providing quality customer service, which is the first step to achieving taxpayer compliance. We have seen a decline in the IRS's ability to provide a sufficient level of customer service in each of the channels that taxpayers use, including telephone, walk-in, and correspondence.

Many taxpayers use the telephone to contact the IRS. Meeting demand with reduced staffing continues to be a struggle, resulting in long wait times, abandoned calls, and taxpayers redialing the IRS toll-free telephone lines for service.

At its walk-in offices, known as taxpayer assistance centers, the IRS has decided to eliminate certain services, such as tax-return preparation, that can be obtained through other channels. The IRS

assisted over 6½ million taxpayers at these service centers in Fiscal Year 2013 but plans to reduce that number by 14 percent this year.

The IRS's ability to process taxpayer correspondence in a timely manner has also declined. The backlog of paper correspondence inventories has substantially increased. The over-age inventory rose from approximately 593,000 at the end of 2012 to almost 1.2 million at the end of 2013.

As with all Federal agencies, the IRS is required to estimate the amount of improper payments made each year and report to Congress on the causes of and steps taken to reduce these payments. The IRS limits its reporting to improper payments associated with the Earned Income Tax Credit. However, in our view, the IRS's assessment should also include payments due to refund fraud, such as identity theft.

Tax-fraud-related identity theft continues to be a growing problem which results in billions of dollars in improper payments. The total impact is significantly greater than the amount the IRS detects and prevents. Using the characteristics of tax returns that the IRS confirmed as involving identity theft, we analyzed tax year 2011 returns and identified approximately 1.1 million undetected returns that have potentially fraudulent refunds totaling approximately \$3.6 billion.

While this is a decrease of \$1.6 billion from the prior year, indicating that the IRS is making progress, significant improvements are still needed. Expanded access to the National Directory of New Hires could immediately provide the IRS with information needed to make substantial improvements in its fraud-detection efforts. Legislation is needed to expand the IRS's authority to access this data.

The Tax Gap is also a continuing challenge. The most recent IRS assessment is that the gross Tax Gap is about \$450 billion annually. Most of this amount, \$376 billion, is attributable to taxpayers underreporting their tax liability. The law provides for certain new reporting requirements, including merchant card reporting and foreign account reporting, to help the IRS identify unreported income. TIGTA will be evaluating the implementation of these requirements this year.

Implementation of tax law changes associated with the Affordable Care Act will also present many challenges for the IRS in the coming years. For example, the Affordable Care Act provides for a refundable tax credit, known as the Premium Tax Credit, to offset an individual's health insurance expenses. As with other refundable credits, there is a risk of improper payments.

Further, in September 2013, we reported that a fraud-mitigation strategy is not in place to guide Affordable Care Act systems development, testing, initial deployment, and long-term operations. The IRS informed us that two new systems are under development that will address fraud risk. However, until these new systems are successfully developed and tested, TIGTA remains concerned that the IRS's existing fraud-detection system may not be capable of identifying and preventing refund fraud. We are also concerned about the protection of confidential taxpayer data that will be provided to the exchanges.

Our review of the IRS's customer service strategy determined that it provides sufficient plans to assist individuals in understanding the tax implications of the Affordable Care Act. The IRS's role in providing customer service in this area will become more prominent in 2015. We will continue to monitor and correct any problems early in the process.

Chairman Crenshaw, Ranking Member Serrano, members of the subcommittee, thank you for the opportunity to share my views.

Mr. CRENSHAW. Thank you.

[The information follows:]

**HEARING BEFORE THE  
COMMITTEE ON APPROPRIATIONS  
SUBCOMMITTEE ON FINANCIAL SERVICES  
AND GENERAL GOVERNMENT  
U.S. HOUSE OF REPRESENTATIVES**

**“OVERSIGHT HEARING – INTERNAL REVENUE  
SERVICE”**



**Testimony of  
The Honorable J. Russell George  
Treasury Inspector General for Tax Administration**

**February 26, 2014**

**Washington, D.C.**



TESTIMONY  
OF  
THE HONORABLE J. RUSSELL GEORGE  
TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION  
*before the*  
COMMITTEE ON APPROPRIATIONS, SUBCOMMITTEE ON  
FINANCIAL SERVICES AND GENERAL GOVERNMENT  
U.S. HOUSE OF REPRESENTATIVES

“OVERSIGHT HEARING – INTERNAL REVENUE SERVICE”

February 26, 2014

Chairman Crenshaw, Ranking Member Serrano, and Members of the Subcommittee, thank you for the opportunity to testify on our recent work related to the most significant challenges currently facing the Internal Revenue Service (IRS). These challenges include providing timely assistance to taxpayers, addressing growing attempts to commit tax fraud, implementing new laws and programs, and improving tax compliance efforts—all while operating with a reduced budget.

The Treasury Inspector General for Tax Administration, also known as TIGTA, is a nationwide organization located in offices throughout the United States. We are statutorily mandated to provide independent audit and investigative services necessary to improve the economy, efficiency, and effectiveness of IRS operations, including the oversight of the IRS Chief Counsel and the IRS Oversight Board. TIGTA's oversight activities are designed to identify high-risk systemic inefficiencies in IRS operations and to investigate exploited weaknesses in tax administration. TIGTA's role is critical in that we provide the American taxpayer with assurance that the approximately 93,800<sup>1</sup> IRS employees who collected over \$2.9 trillion in tax revenue, processed over 147 million individual tax returns, and issued \$364 billion in tax refunds during Fiscal Year 2013,<sup>2</sup> do so in an effective and efficient manner while minimizing the risks of waste, fraud, or abuse.

TIGTA's Office of Audit (OA) reviews all aspects of the IRS tax administration system and provides recommendations to: improve IRS systems and operations; ensure the fair and equitable treatment of taxpayers; and prevent and detect waste, fraud, and abuse. OA places audit emphasis on statutory coverage required by the IRS

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<sup>1</sup> Total IRS staffing as of November 2, 2013.

<sup>2</sup> IRS, *Management's Discussion & Analysis, Fiscal Year 2013*.

Restructuring and Reform Act of 1998 (RRA 98),<sup>3</sup> the American Recovery and Reinvestment Act of 2009,<sup>4</sup> and other laws, as well as areas of concern raised by Congress, the Secretary of the Treasury, the Commissioner of the IRS, and other key stakeholders. The OA has examined specific high-risk issues such as identity theft, refund fraud, improper payments, information technology, security vulnerabilities, complex modernized computer systems, tax collections and revenue, and waste and abuse in IRS operations.

TIGTA's Office of Investigations (OI) protects the integrity of the IRS by investigating allegations of IRS employee misconduct, external threats to employees and facilities, and attempts to impede or otherwise interfere with the IRS's ability to collect taxes. Misconduct by IRS employees manifests itself in many ways, including extortion, theft, taxpayer abuses, false statements, financial fraud, and identity theft. OI places a high priority on its statutory responsibility to protect all IRS employees located in over 670 facilities nationwide. In the last four years, threats directed at the IRS have become the second largest component of OI's work. Physical violence, harassment, and intimidation of IRS employees continue to pose significant challenges to the implementation of a fair and effective system of tax administration. The OI is committed to ensuring the safety of IRS employees and the security of IRS facilities.

For FY 2013, TIGTA has recovered, protected, and identified monetary benefits totaling \$16.6 billion, including cost savings, increased revenue, revenue protection, and court-ordered settlements in criminal investigations.

## **KEY CHALLENGES FACING THE IRS**

In this section of my testimony, I will discuss several of the most significant challenges now facing the IRS as it administers our Nation's tax laws, as the Subcommittee has requested.

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<sup>3</sup> Pub. L. No. 105-206, 112 Stat. 685. 1998 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

<sup>4</sup> Pub. L. No. 111-5, 123 Stat. 115. 2009.

## TAXPAYER SERVICE

Providing quality customer service is the IRS's first step to achieving taxpayer compliance. One of Congress' principal objectives in enacting the RRA 98 was to mandate that the IRS do a better job of meeting the needs of the taxpayers. In the past, TIGTA has evaluated the IRS's efforts in providing quality customer service, providing recommendations for areas of improvement. Although the IRS has implemented certain procedures to better assist the American taxpayer, funding reductions pose a significant challenge.

As a result of the Balanced Budget and Emergency Deficit Control Act,<sup>5</sup> the IRS was required to reduce planned spending from its appropriated accounts by \$594 million for FY 2013. The IRS was also required in FY 2013 to reduce planned spending from its appropriated accounts by \$24 million as the result of an across-the-board rescission.<sup>6</sup> These funding reductions represent a total decrease of \$618 million to the IRS's budget of \$11.8 billion, resulting in a revised annual budget of \$11.2 billion. Overall, the IRS's FY 2013 budget was over \$1 billion less than its FY 2010 budget as a result of the FY 2013 rescission and sequestration<sup>7</sup> and declines in its FY 2011 and FY 2012 budgets.

These continuing budget constraints make it difficult for the IRS to effectively assist taxpayers. As demand for taxpayer services continues to increase, resources have decreased, thereby affecting the quality of customer service that the IRS is able to provide. I would like to provide you with some specific examples.

First, the IRS continues to struggle in providing high quality customer service over the phone. These struggles result in long customer wait times, customers abandoning calls, and customers redialing the IRS toll-free telephone lines<sup>8</sup> for service. Despite other available options, most taxpayers continue to use the telephone as the primary method to make contact with the IRS. In September 2013, TIGTA reported<sup>9</sup> that IRS assistors, as of May 4, 2013, answered approximately 15.6 million calls and

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<sup>5</sup> Pub. L. No. 112-25, 125 Stat. 240. 2011.

<sup>6</sup> A rescission cancels part of an agency's discretionary budget authority and is usually established as a percentage reduction to the budget authority.

<sup>7</sup> Sequestration involves automatic spending cuts of approximately \$1 trillion from FY 2013 through FY 2021 across the Federal Government that took effect on March 1, 2013.

<sup>8</sup> The IRS refers to the suite of 29 telephone lines to which taxpayers can make calls as "Customer Account Services Toll-Free."

<sup>9</sup> TIGTA, Ref. No. 2013-40-124, *Late Legislation Delayed the Filing of Tax Returns and Issuance of Refunds for the 2013 Filing Season* (Sep. 2013).

achieved an approximate 70 percent Level of Service with an Average Speed of Answer of approximately 14 minutes.<sup>10</sup> The IRS plans to provide a 72 percent Level of Service for FY 2014. As of February 1, 2014, approximately 8.8 million taxpayers had contacted the IRS by calling the various customer service toll-free telephone assistance lines. IRS assistors have answered 2.1 million calls and have achieved a 75 percent Level of Service with a 12 minute Average Speed of Answer.

Second, the IRS's ability to process taxpayer correspondence in a timely manner has also declined. Assistors who answer the toll-free telephone lines also handle taxpayer correspondence (including processing amended tax returns and working identity theft cases). During the filing season when call demand is usually at its highest, more resources are shifted to the telephones to answer calls, and correspondence inventory processing is placed on hold until call demand subsides. As call volumes have increased and assistors have been moved to answer telephone calls, the backlog of paper correspondence inventories has substantially increased. This correspondence inventory rose from approximately 628,000 at the end of FY 2010 to almost 2.7 million at the end of FY 2013, representing an increase of nearly 330 percent.

Third, the number of taxpayers assisted by Taxpayer Assistance Centers (TACs) will decrease this fiscal year. Each year, many taxpayers seek assistance from one of the IRS's 386 walk-in offices, called TACs. The IRS assisted over 6.5 million taxpayers in FY 2013 and plans to assist 5.6 million taxpayers in FY 2014, which is 14 percent fewer than in FY 2013. Budget cuts and the IRS's strategy of not offering services at TACs that can be obtained from other service channels, such as the IRS's website, will reduce the number of taxpayers the IRS plans to assist at TACs. In FY 2014, the primary service performed at TACs will consist of answering taxpayers' inquiries about their tax accounts.

In FY 2014, TACs will no longer prepare tax returns, provide tax transcripts, or provide the status of tax refunds. In addition, TAC assistors will answer only basic tax law questions during the filing season and will not answer any tax law questions outside of the filing season. Taxpayers will be referred to Volunteer Income Tax Assistance sites for free tax return preparation or to applications on the IRS's public website to obtain the other services that TACs are no longer providing. For example, tax transcripts can be obtained using the new online "Get Transcript" application; refund status checks can be performed using the "Where's My Refund" application; and

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<sup>10</sup> The average amount of time for an assistor to answer the call after the call is routed to a call center staff.

taxpayers can obtain answers to basic tax law questions from the Interactive Tax Assistance application.

The IRS also assists taxpayers who have been victimized by identity theft. In September 2013, we issued a follow-up report on this issue.<sup>11</sup> Our review evaluated a statistically valid sample of 100 identity theft tax accounts (cases) closed August 1, 2011 through July 31, 2012. We determined that the IRS identified the rightful owner of the Social Security Number in all cases. However, taxpayers continued to face long delays in having their cases resolved. For the 100 cases reviewed, the IRS took an average of 312 days to resolve the case with inactivity (*i.e.*, no work was being performed to resolve the case) averaging 277 days.

## IMPROPER PAYMENTS

The Improper Payments Information Act of 2002<sup>12</sup> requires Federal agencies, including the IRS, to estimate the amount of improper payments made each year. Agencies must report to Congress on the causes of and the steps taken to reduce improper payments and address whether they have the information systems and other infrastructure needed to reduce improper payments. The Improper Payments Elimination and Recovery Act of 2010<sup>13</sup> amended the Improper Payments Information Act of 2002 by redefining the definition of improper payments and strengthening agency reporting requirements. TIGTA is required to review annually the IRS's compliance with the Act's reporting requirements.

The first step in an agency's estimation of improper payments is to conduct annual improper payment risk assessments to identify programs at risk for significant improper payments. TIGTA has reported that the risk assessment process performed annually by the IRS may substantially underestimate the amount of improper payments in tax administration. Specifically, the IRS performed a risk assessment of 15 revenue program funds selected by the Department of the Treasury to evaluate the risk of improper payments. Revenue program funds represent specific individual credits or payments (line items on the tax returns). In January 2013, we reported that, although the IRS completed its Fiscal Year 2011 risk assessments, the method used does not fully consider the risks associated with tax refund payments.<sup>14</sup> As a result, the IRS

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<sup>11</sup> TIGTA, Ref. No. 2013-40-129, *Case Processing Delays and Tax Account Errors Increased Hardship for Victims of Identity Theft* (Sep. 2013).

<sup>12</sup> Pub. L. No. 107-300, 116 Stat. 2350.

<sup>13</sup> Pub. L. No. 111-204, 124 Stat. 2224.

<sup>14</sup> TIGTA, Ref. No. 2013-40-015, *Improper Payments Elimination and Recovery Act Risk Assessments of Revenue Programs Are Unreliable* (Jan. 2013).

does not have a reliable assessment of the risk of improper payments in its revenue program funds. For each of the 15 revenue program funds reviewed, the IRS identified that the fund had a low risk for improper payments. The only program the IRS has designated as high risk is the Earned Income Tax Credit (EITC) Program.

However, prior TIGTA reports indicate that the risk of improper payments for some of these program funds could in fact be significant enough to warrant reporting and tracking under the Improper Payments Information Act of 2002. For example, we reported in September 2011 that the IRS may have erroneously allowed approximately \$3.2 billion in American Opportunity Tax Credits.<sup>15</sup> Moreover, other issues, such as insufficient verification of identity or income, can also pose a significant risk for improper payments. Yet the risk of these types of improper payments is not estimated by the IRS despite prior TIGTA reports which indicate that this risk could be significant. Improper payments due to identity theft are the most significant example of a category that is not estimated by the IRS. As such, we believe the IRS's identification of EITC as the only high risk of improper payments may significantly underestimate the risk of improper payments to tax administration.

In addition to the EITC, the IRS administers numerous other refundable tax credits.<sup>16</sup> The number of these credits has varied over time because some credits are available for a limited period that is set by law. Refundable credits were designed to help low-income individuals reduce their tax burden or to provide incentives for other activities. The EITC, created in 1975,<sup>17</sup> is used to offset the impact of Social Security taxes on low-income families and to encourage them to seek employment. Congress later created the Child Tax Credit and the Additional Child Tax Credit (ACTC)<sup>18</sup> to reflect a family's reduced ability to pay taxes as family size increases. Other refundable credits provide incentives for specific activities, such as obtaining a college education or purchasing health insurance. For example, the American Opportunity Tax Credit allows individuals to receive a credit for higher education expenses. More

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<sup>15</sup> TIGTA, Ref. No. 2011-41-083, *Billions of Dollars in Education Credits Appear to Be Erroneous* (Sep. 2011).

<sup>16</sup> The maximum benefit an individual will receive if a nonrefundable credit is claimed inappropriately is to fully offset his or her tax liability resulting in the individual owing nothing. Refundable credits do not have such limitations. Refundable credits can result in tax refunds even if no income tax is withheld or paid; that is, the credits can exceed the tax liability.

<sup>17</sup> Tax Reduction Act of 1975 § 204, 26 U.S.C § 32.

<sup>18</sup> The ACTC is the refundable portion of the Child Tax Credit. This credit phases out for taxpayers depending upon their income level. Taxpayers with earned income of less than \$3,000 may be eligible for a refundable credit if they have three or more qualifying children and have paid Social Security taxes that exceed their EITC.

recently, the Patient Protection and Affordable Care Act<sup>19</sup> and the Health Care and Education Reconciliation Act of 2010 (Affordable Care Act) includes the Premium Tax Credit that provides for a tax credit beginning in Tax Year (TY) 2014 to offset an individual's health insurance expenses.

Although refundable credits provide benefits to individuals, the unintended consequence of these credits is that they can result in the issuance of improper payments and can be the targets of unscrupulous individuals who file erroneous claims for these credits.

I would now like to highlight some of our work relating to the refundable credits still in existence, providing improper payment estimates and amounts when available; the IRS's actions to address these improper payments; and recommendations we have made to reduce these payments.

**Earned Income Tax Credit** – The IRS continues to report that more than 20 percent of EITC payments are issued improperly each year. In FY 2013, the IRS estimates it issued between \$13 and \$15 billion in improper EITC payments.

The IRS is unlikely to achieve any significant reduction in EITC improper payments despite having implemented numerous processes to identify and prevent such payments. For FY 2013, the IRS reported that its efforts protected approximately \$4 billion in erroneous EITC payments and identified more than 10,000 paid tax return preparers who were not complying with EITC due diligence requirements.<sup>20</sup> Although significant amounts of the EITC are being protected, the IRS has made little improvement in reducing improper EITC payments as a whole since it has been required to report estimates of these payments to Congress. The IRS acknowledged in its Fiscal Year 2012 Improper Payment report to TIGTA<sup>21</sup> that further reductions in the EITC improper payment rate will be difficult to achieve.

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<sup>19</sup> Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified as amended in scattered sections of U.S. Code), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029.

<sup>20</sup> Due diligence requirements require paid tax return preparers to gather, verify, and maintain specific information when filing a tax return claiming the EITC.

<sup>21</sup> IRS, *Report on Earned Income Tax Credit (EITC) Improper Payments Executive Order 13520: Reducing Improper Payments* (March 14, 2013).

However, we have conducted a number of audits that have identified specific actions that the IRS could take to reduce EITC improper payments.<sup>22</sup> While the IRS has implemented some of our recommendations, it has not taken action to address key recommendations aimed at preventing or reducing improper EITC payments. For example, we reported in December 2008<sup>23</sup> that the IRS did not have the resources needed to examine each of the potentially erroneous claims it identifies, resulting in the majority of the improper claims being paid. We recommended that the IRS conduct a study to identify alternative processes that would expand its ability to effectively and efficiently identify and adjust erroneous EITC claims. This included working with the Assistant Secretary of the Treasury for Tax Policy to obtain authority for an improved process that can make use of its success in combining external data with filters that identify EITC claims as likely being erroneous. The IRS agreed with our recommendation and also agreed to work with the Assistant Secretary of the Treasury for Tax Policy to obtain the authority necessary to implement alternative compliance processes. However, the IRS's FY 2012 EITC Improper Payment report to TIGTA indicated that it has not taken any steps to identify or implement alternative compliance methods.

The IRS estimates that two-thirds of EITC claims are prepared with the assistance of paid tax return preparers. As such, the IRS established the Return Preparer Program and began implementing new preparer requirements in FY 2011. These requirements include: 1) requiring all individuals who sign a tax return as a paid tax return preparer to register and obtain a Preparer Tax Identification Number (PTIN); and 2) establishing competency testing for all paid tax return preparers. The IRS stated in its 2012 report to TIGTA on EITC improper payments that the regulation of tax preparers will drive increased EITC compliance, decrease fraud, and reduce the improper payment rate.

There have been some legal challenges to these new tax preparer regulations. The U. S. Court of Appeals for the Eleventh Circuit recently held that the IRS has the

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<sup>22</sup> TIGTA, Ref. No. 2005-40-133, *Administration of the Earned Income Tax Credit Program Has Improved, but Challenges Continue* (Aug. 2005); TIGTA, Ref. No. 2006-40-103, *Controls Can Be Improved to Ensure Advance Earned Income Credit Reported on Individual Income Tax Returns Is Accurate* (July 2006); TIGTA, Ref. No. 2009-40-024, *The Earned Income Tax Credit Program Has Made Advances; However, Alternatives to Traditional Compliance Methods Are Needed to Stop Billions of Dollars in Erroneous Payments* (Dec. 2008); TIGTA, Ref. No. 2010-41-116, *Actions Can Be Taken to Improve the Identification of Tax Return Preparers Who Submit Improper Earned Income Tax Credit Claims* (Sep. 2010).

<sup>23</sup> TIGTA, Ref. No. 2009-40-024, *The Earned Income Tax Credit Program Has Made Advances; However, Alternatives to Traditional Compliance Methods Are Needed to Stop Billions of Dollars in Erroneous Payments* (Dec. 2008).



authority to charge a user fee for tax return preparers to obtain and renew a PTIN.<sup>24</sup> However, in another case, the U. S. Court of Appeals for the District of Columbia affirmed the lower court's ruling that the IRS does not have the authority to issue a regulation requiring registration, examination and continuing education for tax return preparers.<sup>25</sup>

Despite the court's ruling in the District of Columbia case, the IRS has penalty authority that can be used to reduce EITC improper payments. Beginning with the 2012 Filing Season, paid tax return preparers who prepare a tax return claiming the EITC must include Form 8867, *Paid Preparer's Earned Income Credit Checklist*, with the tax return. Preparers who do not adhere to this requirement can be assessed a \$500 due diligence penalty for each tax return they submit without the required Form 8867. However, we found that the IRS has yet to implement the expanded EITC due diligence penalties.

We reported in September 2013<sup>26</sup> that many paid tax return preparers continue to not comply with EITC due diligence requirements. As of May 2, 2013, we identified 708,298 tax returns claiming more than \$2 billion in the EITC where the IRS determined that the tax return preparer either did not include the required Form 8867 or included an incomplete Form 8867. We reported similar noncompliance by paid tax return preparers during the 2012 Filing Season.<sup>27</sup> As of May 3, 2012, there were almost 534,000 tax returns with EITC claims totaling more than \$1.5 billion that were filed without the required Form 8867.

As of November 13, 2013, the IRS stated that it was considering a number of options for assessing the due diligence penalty but had not yet determined how to proceed. The IRS indicated that its goal is to assess applicable penalties before the next filing season based on time and resources. A lack of an effective process to assess these penalties is of concern as the IRS continues to report billions of dollars in improper EITC payments each year.

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<sup>24</sup> *Brannen v. United States*, 682 F.3d 1361 (11th Cir. 2012).

<sup>25</sup> *Loving v. Internal Revenue Service*, 2014 U.S. App. LEXIS 2512 (D.C. Cir. Feb. 11, 2014), *aff'd* 917 F. Supp.2d 67 (D.D.C. 2013).

<sup>26</sup> TIGTA, Ref. No. 2013-40-124, *Late Legislation Delayed the Filing of Tax Returns and Issuance of Refunds for the 2013 Filing Season* (Sep. 2013).

<sup>27</sup> TIGTA, Ref. No. 2012-40-119, *The Majority of Individual Tax Returns Were Processed Timely, but Not All Tax Credits Were Processed Correctly During the 2012 Filing Season* (Sep. 2012).

**Additional Child Tax Credit** – In 2009, we reported a significant increase in ACTC claims by filers who were ineligible or unable to obtain a Social Security Number.<sup>28</sup> These individuals are not authorized to work in the United States and filed tax returns using an Individual Taxpayer Identification Number (ITIN).<sup>29</sup> The ACTC claims made by these filers have grown substantially. While ITIN filers are no longer eligible to claim the EITC, ITIN filers can claim the ACTC.

For Processing Year<sup>30</sup> 2005, a total of 796,000 ITIN filers claimed ACTCs totaling \$924 million. This grew to 2.3 million ITIN filers who claimed ACTCs totaling \$4.2 billion for Processing Year 2010. The increase was due in part to changes in the law which increased the amount of the ACTC that can be claimed as well as making more individuals eligible for the credit. Our review of these claims found that a significant number of ITIN filers are filing multiple claims to obtain the ACTC for prior year tax returns (e.g., filing returns for TYs 2007, 2008, and 2009 at the same time). For example, in Processing Year 2010, approximately 238,000 ITIN filers submitted more than 608,000 tax returns for multiple years at the same time and claimed more than \$1 billion in ACTCs on those returns.<sup>31</sup>

With this increase in claims for the ACTC, there has also been an increased demand for ITINs in order to file these returns. For Fiscal Year 2011, the IRS processed more than 2.2 million ITIN applications.<sup>32</sup> Along with the increased demand for ITINs comes an increased risk that individuals may submit questionable applications to obtain an ITIN for use in filing a tax return to erroneously claim the ACTC. In July 2012, we reported that the ITIN application review and verification process was so deficient that there was no assurance that ITINs were not being assigned to individuals who submitted questionable applications.<sup>33</sup> This, in turn, could allow individuals to use these ITINs to file tax returns to commit tax refund fraud.

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<sup>28</sup> TIGTA, Ref. No. 2009-40-057, *Actions Are Needed to Ensure Proper Use of Individual Taxpayer Identification Numbers and to Verify or Limit Refundable Credit Claims* (Mar. 2009).

<sup>29</sup> An Individual Taxpayer Identification Number is available to individuals who are required to have a taxpayer identification number for tax purposes, but do not have and are not eligible to obtain a Social Security Number because they are not authorized to work in the United States.

<sup>30</sup> The calendar year the tax return or document is processed by the IRS.

<sup>31</sup> TIGTA, Ref. No. 2011-41-061, *Individuals Who Are Not Authorized to Work in the United States Were Paid \$4.2 Billion in Refundable Credits* (July 2011).

<sup>32</sup> ITIN processing uses the full-time equivalent of 463 IRS employees.

<sup>33</sup> TIGTA, Ref. No. 2012-42-081, *Substantial Changes Are Needed to the Individual Taxpayer Identification Number Program to Detect Fraudulent Applications* (July 2012).

In a May 2013 follow-up review,<sup>34</sup> we reported that the IRS initiated corrective actions to address the majority of recommendations included in our prior audit report. These actions significantly improved the identification of questionable ITIN applications. After the new procedures were put into place, the number of applications rejected as questionable increased from 226,011 for the period July through December 2011 to 340,659 for the same period in 2012. In Processing Year 2013, the number of ITIN filers claiming the ACTC decreased to 1.8 million ITIN filers claiming \$3.9 billion in ACTC.

We are currently conducting an audit to assess the IRS's efforts to identify and address the causes of EITC and ACTC improper payments, and to evaluate the IRS's efforts to identify alternative processes to address improper EITC refunds in response to our recommendation. We plan to issue a report later in Fiscal Year 2014.<sup>35</sup>

**American Opportunity Tax Credit** – The Recovery Act amended the Hope Scholarship Credit<sup>36</sup> to allow a refundable tax credit — called the American Opportunity Tax Credit (AOTC). The AOTC allowed individuals to receive a credit for higher education expenses up to \$2,500 per student per year for TYs 2009 and 2010, with up to \$1,000 being refundable. The American Taxpayer Relief Act of 2012<sup>37</sup> subsequently extended the AOTC through December 31, 2017.

As part of our Recovery Act oversight, we reported in September 2011<sup>38</sup> that the IRS lacked effective processes to identify taxpayers who claim erroneous education credits. As a result, 2.1 million taxpayers received a total of \$3.2 billion in education credits (\$1.6 billion in refundable credits and \$1.6 billion in nonrefundable credits) that appeared to be erroneous. Each of these taxpayers claimed students for whom there was no associated Form 1098-T, *Tuition Statement*,<sup>39</sup> in IRS files to substantiate the student's attendance at an educational institution. We have recently initiated a

<sup>34</sup> TIGTA, Ref. No. 2013-40-052, *Review and Verification of Individual Taxpayer Identification Number Applications Has Improved, However, Additional Processes and Procedures Are Still Needed* (May 2013).

<sup>35</sup> TIGTA, Audit No. 201340031, *Efforts to Reduce Erroneous Refundable Child-Based Tax Credit Payments*, report planned for March 2014.

<sup>36</sup> The Hope Scholarship Credit was established to assist middle-class families with the costs associated with a college degree.

<sup>37</sup> Pub. L. No. 112-240, 126 Stat. 2319 (2013).

<sup>38</sup> TIGTA, Ref. No. 2011-41-083, *Billions of Dollars in Education Credits Appear to Be Erroneous* (Sep. 2011).

<sup>39</sup> Institutions of higher education are required to provide each student with a Form 1098-T, *Tuition Statement*, that reports payments received or amounts billed for qualified tuition and related expenses, scholarships and grants given, adjustments made for a prior year, and the name and location of the institution. Educational institutions are required to provide a Form 1098-T to students who attend their institution and a duplicate copy to the IRS.

follow-up review to assess the IRS's efforts to improve the detection and prevention of erroneous Education Credit claims.<sup>40</sup>

**Premium Tax Credit**— The Affordable Care Act provides for a refundable tax credit to offset an individual's health insurance expenses. Beginning in TY 2014, some low to moderate income individuals eligible to obtain health insurance through one of the State Exchanges or the Federal Exchange (collectively referred to as the Exchanges)<sup>41</sup> may be eligible for a refundable credit to assist them in paying monthly insurance premiums. The amount of the credit is determined by an individual's income in relation to the Federal poverty level, among other factors. In October 2013, the IRS began working with the Exchanges to provide a computation of individuals' estimated maximum monthly Premium Tax Credit.<sup>42</sup> Individuals can elect the amount of credit they want advanced. Qualified individuals can elect to either: 1) have the monthly credit sent directly to their insurance provider as an advanced payment (Advanced Premium Tax Credit)<sup>43</sup> to lower the amount of monthly premiums they would pay out-of-pocket; or 2) wait to receive the credit when they file their TY 2014 tax return. The Congressional Budget Office estimates that six million individuals will receive Premium Tax Credits totaling \$16 billion in Calendar Year (CY) 2014.<sup>44</sup>

Like other refundable credits, there is a risk for improper payments with the Premium Tax Credit. For example, Advanced Premium Tax Credits are computed using a number of factors, including an individual's projected 2014 income, family size, etc. The Exchanges rely on information provided by individuals during the application process as well as information provided by third-parties, including the IRS, to estimate an individual's eligibility to receive the credit. However, it is not until the individual files his or her TY 2014 tax return during CY 2015 that the IRS will know the individual's actual income for 2014 and the amount of the tax credit the individual is entitled to receive.

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<sup>40</sup> TIGTA, Audit No. 201440015, *Efforts to Identify and Prevent Erroneous Education Credits – Follow-up*, report planned for June 2014.

<sup>41</sup> Exchanges are intended to allow eligible individuals to obtain health insurance, and all Exchanges, whether State-based or established and operated by the Federal Government, will be required to perform certain functions.

<sup>42</sup> A refundable tax credit to assist individuals and families in purchasing health insurance coverage through an Exchange.

<sup>43</sup> An Advanced Premium Tax Credit is paid in advance to a taxpayer's insurance company to help cover the cost of premiums.

<sup>44</sup> Congressional Budget Office data tables, *Effects on Health Insurance and the Federal Budget for the Insurance Coverage Provisions in the Affordable Care Act—May 2013 Baseline*, published May 14, 2013.

Individuals who receive an Advanced Premium Tax Credit will reconcile the amount received to the amount of Premium Tax Credit they are eligible to receive based on their actual 2014 income and family size when they file their 2014 tax return. Individuals who are eligible to receive the Premium Tax Credit but did not receive an advanced credit can claim the credit on their 2014 tax return. Individuals who received more than they were entitled to in the form of an Advanced Premium Tax Credit will be responsible for repaying all or part of the credit paid. The IRS will assess the additional credit on the taxpayer's account and attempt to collect it.

We have developed a multi-audit strategy to evaluate the IRS's implementation of the Premium Tax Credit. To date, we have completed evaluations of the IRS's development of needed information systems and the adequacy of the IRS's plans to provide customer service to individuals seeking assistance with the Premium Tax Credit. In September 2013, we reported that a fraud mitigation strategy is not in place to guide Affordable Care Act systems development, testing, initial deployment, and long-term operations.<sup>45</sup> The IRS informed us that two new systems are under development that will address Affordable Care Act tax refund fraud risk. However, until these new systems are successfully developed and tested, TIGTA remains concerned that the IRS's existing fraud detection system may not be capable of identifying Affordable Care Act refund fraud or schemes prior to the issuance of tax refunds.

Currently, we are in the process of evaluating the accuracy of the IRS's computation of the maximum monthly Premium Tax Credit for use by the Exchanges.<sup>46</sup> Future reviews will evaluate the adequacy of the IRS's controls to verify the accuracy of Premium Tax Credit claims and will also assess the impact that delayed employer health insurance reporting will have on the IRS's ability to verify these claims when tax returns are processed.

**Fuel Tax Credit**— Individual taxpayers may claim credits for Federal excise taxes paid on fuels used for tax-exempt purposes, such as farming and off-highway businesses. During Processing Year 2011, approximately \$176 million in fuel tax credits were claimed by individual taxpayers. For the past several years, the IRS has listed Fuel Tax Credit fraud scams as an example of one of the "Dirty Dozen" tax scams. In an ongoing audit, we analyzed Form 1040 tax return data and determined that over 20 percent of tax returns claiming a Fuel Tax Credit of \$100 or more had questionable characteristics, such as little or no reported income from self-employment

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<sup>45</sup> TIGTA, Ref. No. 2013-23-119, *Affordable Care Act: Improvements Are Needed to Strengthen Systems Development Controls for the Premium Tax Credit Project* (Sep. 2013).

<sup>46</sup> TIGTA, Audit No. 201340335, *Affordable Care Act: Accuracy of the Income and Family Size Verification and Advanced Premium Tax Credit Calculation*, report planned for May 2014.

or farming.<sup>47</sup> We provided IRS management with listings of questionable Processing Year 2011 and 2012 tax returns claiming the fuel tax credit. As of February 2014, the IRS has included over 3,600 tax returns in the correspondence examination stream.

## IDENTITY THEFT AND TAX REFUND FRAUD

While refundable tax credits increase the risk of potentially fraudulent tax refunds, other issues concerning tax administration can also pose a significant risk for improper payments. For example, the IRS does not have third-party information to effectively verify income and withholding when tax returns are processed. The IRS is also challenged with the rapidly growing problem of identity theft tax refund fraud, including the use of Social Security Numbers of and by prisoners to file false tax returns, and tax fraud related to the use of stolen Employer Identification Numbers (EIN).<sup>48</sup>

### Identity Theft

The IRS has described identity theft as the number one tax scam for 2014.<sup>49</sup> The IRS has made this issue one of its top priorities and has made some progress; however, significant improvements are still needed.

As of September 28, 2013, the IRS had identified more than 2.5 million incidents of identity theft in CY 2013. As of December 31, 2013, the IRS reported that during the 2013 Filing Season it stopped the issuance of more than \$10.7 billion in potentially fraudulent tax refunds associated with over 1.8 million tax returns classified as involving identity theft.

In September 2013, TIGTA reported that the impact of identity theft on tax administration continues to be significantly greater than the amount the IRS detects and prevents.<sup>50</sup> Using the characteristics of tax returns that the IRS has confirmed as involving identity theft and income and withholding information the IRS received in 2012 late in the filing season and in early 2013, we analyzed TY 2011 tax returns processed

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<sup>47</sup> TIGTA, Audit No. 201230024, *Fuel Tax Credits*, report planned for July 2014.

<sup>48</sup> An EIN is a Federal Tax Identification Number used to identify a taxpayer's business account. The EIN is used by employers, sole proprietors, corporations, partnerships, nonprofit associations, trusts and estates, government agencies, certain individuals, and other types of businesses.

<sup>49</sup> IRS Press Release, IR-2014-16 (February 19, 2014), available at <http://www.irs.gov/uac/Newsroom/IRS-Releases-the-Dirty-Dozen-Tax-Scams-for-2014-Identity-Theft-Phone-Scams-Lead-List>.

<sup>50</sup> TIGTA, Ref. No. 2013-40-122, *Detection Has Improved; However, Identity Theft Continues to Result in Billions of Dollars in Potentially Fraudulent Tax Refunds* (Sep. 2013).

during the 2012 Filing Season and identified approximately 1.1 million undetected tax returns where the primary Taxpayer Identification Number on the tax return was a Social Security Number. The undetected tax returns have potentially fraudulent tax refunds totaling approximately \$3.6 billion, which is a decrease of \$1.6 billion compared to the \$5.2 billion we reported for TY 2010.<sup>51</sup>

In addition, we expanded our TY 2011 analysis to include tax returns where the primary Taxpayer Identification Number on the tax return is an ITIN. We identified more than 141,000 TY 2011 tax returns filed with an ITIN that have the same characteristics as IRS-confirmed identity theft tax returns. Potentially fraudulent tax refunds issued for these undetected tax returns totaled approximately \$385 million, which is in addition to the approximately \$3.6 billion referred to earlier. In total, the IRS could issue potentially fraudulent refunds of approximately \$4 billion annually as a result of identity theft tax refund fraud.

A common characteristic of tax returns filed by identity thieves is the reporting of false income and withholding to generate a fraudulent tax refund. Another aspect to this problem is that many individuals who are victims of identity theft may be unaware that their identity has been stolen and used to file fraudulent tax returns. These individuals are typically those who are not required to file a tax return.<sup>52</sup>

The IRS continues to expand its efforts to identify fraudulent tax returns and prevent the payment of tax refunds by processing all individual tax returns through identity theft screening filters. These filters look for known characteristics of identity theft cases to detect fraudulent tax returns before they are processed and before any tax refunds are issued. In Processing Year 2012, there were 11 filters that identified approximately 325,000 tax returns and prevented approximately \$2.2 billion in fraudulent refunds from being issued. In Processing Year 2013, the number of filters increased to approximately 80, which has enhanced the IRS's ability to identify identity theft tax refund fraud. As of September 30, 2013, the IRS indicated that it had identified 561,033 tax returns and prevented approximately \$2.5 billion in fraudulent tax refunds from being issued. This represents a 157 percent increase over the number that the IRS identified for the same period in Processing Year 2012.<sup>53</sup>

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<sup>51</sup> TIGTA, Ref. No. 2012-42-080, *There Are Billions of Dollars in Undetected Tax Refund Fraud Resulting From Identity Theft* (July 2012).

<sup>52</sup> Individuals who generally are not required to file a tax return include children, deceased individuals, elderly, and individuals who earn less than their standard deduction or earn non-taxable income such as some Social Security benefits.

<sup>53</sup> The IRS indicated that it had identified 218,156 tax returns and prevented approximately \$1.5 billion in fraudulent tax refunds from being issued as of September 30, 2012.

Tax returns detected by the various expanded filters are held during processing until the IRS can verify the taxpayers' identities. IRS employees attempt to contact these individuals and request information to verify that the individual filing the tax return is the legitimate taxpayer. If the IRS cannot confirm the filer's identity, it suspends processing of the tax return to prevent the issuance of a fraudulent refund.

In January 2012, the IRS created the Identity Theft Clearinghouse (the Clearinghouse) within its Criminal Investigation division. The Clearinghouse was created to accept tax fraud-related identity theft leads from the IRS's Criminal Investigation field offices. The Clearinghouse performs research, develops each lead for the field offices, and provides support for ongoing criminal investigations involving identity theft. As of September 30, 2013, the Clearinghouse had received 3,962 identity theft leads that have resulted in the development of 485 investigations.

Finally, the IRS has significantly expanded the number of tax accounts that it locks by placing an indicator on the individual's tax account.<sup>54</sup> In Processing Year 2011, the IRS began locking taxpayers' accounts where the IRS Master File<sup>55</sup> and Social Security Administration data showed a date of death. The IRS places a unique identity-theft indicator to lock the individual's tax account if he or she is deceased. Electronically filed tax returns using the Social Security Number of a locked account will be rejected (the IRS will not accept the tax return for processing). Paper tax returns will be processed; however, the tax returns will not post to the taxpayer's account due to the account lock, and a refund will not be issued.

Between January 2011 and September 2013, the IRS had locked approximately 11 million deceased taxpayer accounts, which will assist the IRS in preventing future identity theft fraudulent tax refunds from being issued. As of September 30, 2013, the IRS had rejected 404,490 e-filed tax returns during the 2013 Filing Season. Additionally, the IRS has prevented the issuance of approximately \$10 million in fraudulent tax refunds since the inception of the lock on paper tax returns. In November 2013, the Chairman of the Senate Finance Committee proposed restricting access to the Social Security Administration's public Death Master File, which would help the IRS's efforts to reduce tax fraud via the use of a deceased individual's Social Security Number.

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<sup>54</sup> When an account is locked, tax refunds are not processed.

<sup>55</sup> The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.



Despite these improvements, the IRS could continue to expand the use of characteristics of confirmed identity theft cases to improve its ability to detect and prevent the issuance of fraudulent tax refunds. As we reported in July 2008,<sup>56</sup> July 2012, and again in September 2013, the IRS is not in compliance with direct-deposit regulations that require tax refunds to be deposited into an account only in the name of the individual listed on the tax return. Direct deposit, which now includes debit cards, provides the ability to receive fraudulent tax refunds quickly, without the difficulty of having to negotiate a tax refund paper check. The majority of the TY 2011 tax returns we identified with indicators of identity theft (84 percent) involved the use of direct deposit to obtain tax refunds totaling approximately \$3.5 billion. There are indications that abusive practices are still ongoing. For example, one bank account received 446 direct deposits totaling over \$591,000.<sup>57</sup>

To improve the IRS's conformance with direct-deposit regulations and to help minimize fraud, TIGTA recommended that the IRS limit the number of tax refunds being sent to the same direct-deposit account. By limiting the number of tax refunds that can be deposited into the same account, the IRS could minimize losses associated with fraud. As of December 2013, the IRS is still considering this recommendation, but the IRS did develop new filters for the 2013 Filing Season to identify and stop tax returns with similar direct deposit and address characteristics. As of September 26, 2013, the IRS indicated that it had identified 267,838 tax returns using these filters and prevented approximately \$817 million tax refunds from being issued. We will be initiating a follow-up review to assess the IRS's efforts to identify and stop tax returns in the 2013 Filing Season with similar direct deposit and address characteristics.<sup>58</sup>

In addition, in January 2013, the IRS implemented a pilot program with the Department of the Treasury Fiscal Service<sup>59</sup> designed to allow financial institutions to reject direct deposit tax refunds based on mismatches between the account name and the name on the tax return. Once the refund is identified by the institution, it is sent back to the Fiscal Service to be routed back to the IRS. As of September 30, 2013, there have been 20,051 refunds returned from financial institutions totaling more than \$66 million. This is a promising first step in recovering fraudulent tax refunds issued via direct deposit.

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<sup>56</sup> TIGTA, Ref. No. 2008-40-182, *Processes Are Not Sufficient to Minimize Fraud and Ensure the Accuracy of Tax Refund Direct Deposits* (Sep. 2008).

<sup>57</sup> TIGTA, Ref. No. 2013-40-122, *Detection Has Improved; However, Identity Theft Continues to Result in Billions of Dollars in Potentially Fraudulent Tax Refunds* (Sep. 2013).

<sup>58</sup> TIGTA, Audit No. 201440001, *Detection and Prevention of Identity Theft on Individual Tax Accounts – Follow-Up*.

<sup>59</sup> Formerly, the Department of the Treasury Financial Management Service.

Identifying potential identity theft tax fraud is the first step. Once the IRS identifies a potential identity theft tax return, it must verify the identity of the individual filing the return. However, verifying whether the returns are fraudulent will require additional resources. Using IRS estimates, it would cost approximately \$22 million to screen and verify the more than 1.2 million tax returns that we identified as not having third-party information on income and withholding. In August 2013, the IRS Principal Deputy Commissioner testified that more than 3,000 IRS employees are currently working on identity theft – more than double the number at the start of the previous filing season.

Without the necessary resources, it is unlikely that the IRS will be able to work the entire inventory of potentially fraudulent tax returns it identifies. The IRS selects only those tax returns for which it can verify the identity of the taxpayer and/or the income based on available resources. If the IRS does not have the resources to work the remainder of the potentially fraudulent tax returns it identifies, the refunds for those returns will be issued. The net cost of failing to provide the necessary resources is substantial, given that the potential revenue loss to the Federal Government of these tax fraud-related identity theft cases is billions of dollars annually.

#### TIGTA Criminal Investigations of Identity Theft and Impersonation Scams

Identity theft has a negative impact on the economy, and the damage it causes to its victims can be personally, professionally, and financially devastating. When individuals steal identities and file fraudulent tax returns to obtain fraudulent refunds before the legitimate taxpayers file, the crime is tax fraud, which falls within the programmatic responsibility of IRS Criminal Investigation. TIGTA's Office of Investigations focuses its limited resources on investigating identity theft characterized by any type of IRS employee involvement, the misuse of client information by tax preparers, or the impersonation of the IRS through phishing<sup>60</sup> schemes and other means. Where there is overlapping jurisdiction, TIGTA and IRS Criminal Investigation will work together to bring identity thieves to justice.

Tax fraud-related identity theft extends beyond the borders of the United States and its possessions. A notable instance of foreign-based identity theft occurred in 2007 when individuals created a phishing site that mimicked the legitimate IRS Free File

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<sup>60</sup> Phishing is an attempt by an individual or group to solicit personal and financial information from unsuspecting users in an electronic communication by masquerading as trustworthy entities such as government agencies, popular social websites, auction sites, online payment processors, or information technology administrators.

Alliance site.<sup>61</sup> The perpetrator, a Belarusian national, along with his co-conspirators, collected taxpayer data, altered the tax returns, and caused approximately \$200,000 in stolen refunds to be deposited into bank accounts he controlled.<sup>62</sup>

Currently, TIGTA is investigating several cases that involve international identity theft potentially impacting nearly 30,000 victims with estimated fraudulent tax refund claims of between \$73 million and \$148 million. A recent example of this activity involved TIGTA's arrest, when he returned to the United States, of a Nigerian foreign national for aggravated identity theft, wire fraud, and conspiracy charges relating to fraudulent tax returns. During a subsequent plea agreement, he admitted to using victim identities to e-file more than 80 fraudulent tax returns requesting more than \$400,000.<sup>63</sup> In another example, TIGTA Office of Investigations arrested two subjects in July 2013 who were involved in a conspiracy to steal patient identities from a Virginia-based health care facility where they were employed.<sup>64</sup> The subjects filed fraudulent Federal tax returns in the victims' names attempting to collect more than \$400,000 in fraudulent returns, and "a substantial part of the scheme was committed from outside the United States and the offense involved sophisticated means."<sup>65</sup> One of the subjects was sentenced to 57 months of imprisonment and the other sentenced to 81 months of imprisonment.<sup>66</sup> Each subject was ordered to make restitution to the IRS in the amount of \$116,404.<sup>67</sup>

IRS employees are entrusted with the sensitive personal and financial information of taxpayers. Using this information to perpetrate a criminal scheme for personal gain negatively impacts our Nation's voluntary tax system and it can generate widespread distrust of the IRS. TIGTA aggressively investigates IRS employees involved in identity theft-related tax refund fraud and refers these investigations to the Department of Justice for prosecution. Many of these employees face significant prison sentences as well as the loss of their jobs if convicted. The following cases highlight TIGTA's work in this area.

In November 2013, TIGTA special agents arrested an IRS Tax Examining Technician for aggravated identity theft and conspiracy.<sup>68</sup> The IRS employee conspired

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<sup>61</sup> The Free File Alliance is a nonprofit coalition of industry-leading tax software companies that partnered with the IRS to help millions of Americans prepare and e-file their Federal tax returns for free.

<sup>62</sup> D. Mass. Plea Agr. filed Jan. 19, 2011; D. Mass. Indict. filed June 23, 2010.

<sup>63</sup> N.D.N.Y. Plea Agr. filed July 11, 2012.

<sup>64</sup> E.D. Va. Arrest Warrant returned July 11, 2013.

<sup>65</sup> E.D. Va. Indict. filed Aug. 7, 2013; E.D. Va. Statement of Facts filed Oct. 11, 2013.

<sup>66</sup> E.D. Va. Judgment filed Jan. 13, 2014 and E.D. Va. Judgment filed Jan. 27, 2014.

<sup>67</sup> E.D. Va. Restitution Order filed Jan. 10, 2014 and E.D. Va. Restitution Order filed Jan. 24, 2014.

<sup>68</sup> N.D. Ga. Executed Arrest Warrant dated Nov. 26, 2013.

with another individual to divert a tax refund belonging to another taxpayer by changing the taxpayer's mailing address without the taxpayer's permission, causing a refund of \$595,901 to be mailed to her co-conspirator.<sup>69</sup> Further criminal action is pending.

TIGTA investigated an IRS employee who accessed a family member's tax return information that was stored in an IRS database and used that information to file a false amended tax return. She directed the tax refund generated from the false tax return to her own address. The IRS employee pled guilty in July 2013 to a criminal information<sup>70</sup> charging her with knowingly and willingly disclosing tax return and return information collected by the Department of the Treasury to an unauthorized party.<sup>71</sup>

In another case, a former IRS employee was indicted for wire fraud and aggravated identity theft in October 2013. From at least 2008 through March 2011, the subject, while an IRS employee, obtained the personal identifiers of individuals without their consent or knowledge and completed individual Federal tax returns and State tax returns.<sup>72</sup> Using a false identity, the subject of this investigation established an account with an Internet service provider, an e-mail address in order to submit the false returns to the IRS and the State of Missouri, and generated fraudulent refunds. She opened bank accounts with at least six financial institutions in five different States and used the routing number, account number, and debit card number on the fraudulent returns to direct payment or credit to accounts she controlled. Through her scheme, the subject unlawfully acquired approximately \$326,260 (\$211,474 from the IRS and \$114,786 from the State of Missouri) in fraudulent tax refunds.<sup>73</sup>

TIGTA also investigates tax preparers who misuse their clients' information to commit identity theft-related refund fraud. For example, TIGTA investigated a tax preparer who stole the personal identifiers of her clients and filed numerous fraudulent tax returns without their permission or knowledge. The tax preparer, who was indicted in April 2013 on charges of aggravated identity theft, wire fraud, mail fraud and false claims, prepared and filed more than 200 fraudulent tax returns and defrauded the U.S. Government of more than \$1 million in tax refunds. She used the proceeds from the fraudulently obtained tax returns to purchase 20 real properties in Arizona.<sup>74</sup>

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<sup>69</sup> N.D. Ga. Crim. Compl. dated Nov. 25, 2013.

<sup>70</sup> N.D. Ga. Plea Agr. filed July 11, 2013.

<sup>71</sup> N.D. Ga. Crim. Info. filed June 10, 2013.

<sup>72</sup> W.D. Mo. Indict. filed Oct. 2, 2013.

<sup>73</sup> *Id.*

<sup>74</sup> S.D. Cal. Indict. filed Apr. 13, 2013.

In another case, TIGTA investigated a tax preparer who stole the personal identifiers of several individuals and unlawfully disclosed the information to others to fraudulently obtain tax refunds. According to the indictment, the subject of the investigation worked as a tax preparer from January 2002 to June 2008. In 2010, he used the personal identifiers of other individuals to file false income tax returns and obtain refunds from the IRS. The preparer obtained most of the personal identifiers in the course of his prior employment as a tax preparer and from other employment positions he held. He disclosed this information to co-conspirators so they could also file false income tax returns and obtain refunds from the IRS. The subject and his co-conspirators ultimately defrauded or attempted to defraud the IRS of at least \$560,000 in tax refunds.<sup>75</sup> The subject was sentenced to 15 years in prison and ordered to pay restitution in the amount of \$515,257.75.<sup>76</sup>

In addition to these TIGTA investigations, the IRS announced in February 2013 the results of a nationwide effort with the Department of Justice and local U.S. Attorneys' offices focusing on identity theft suspects in 32 States and Puerto Rico, which involved 215 cities and surrounding areas. This joint effort involved 734 enforcement actions related to identity theft and refund fraud, including indictments, informations, complaints, and arrests.

Criminals have been impersonating the IRS for years. While the fraud schemes may change, the motive remains the same: to bilk honest taxpayers out of their hard-earned money. Scammers and thieves often prey on immigrants and the elderly and sometimes even resort to threats. For example, in the summer of 2013, TIGTA began receiving numerous complaints from around the country about suspicious callers claiming to be IRS employees collecting taxes from recent IRS audits. The callers demanded that the tax payments be made to pre-paid credit cards and threatened arrest, suspension of business or driver's licenses, and even deportation if the callers' demands were not met. In many cases, the callers became hostile and insulting. Investigative information indicates that the calls originated from outside the United States and are likely part of an organized criminal enterprise. To date, the TIGTA Hotline has received over 15,000 calls related to this scam and it is estimated that the scheme has resulted in \$945,000 in payments made by the victims. TIGTA special agents are actively investigating these crimes against taxpayers.

Identity theft and other fraud schemes targeting senior citizens continue to be on the rise. Sweepstakes and lottery scams, e-mail and phishing scams, and investment

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<sup>75</sup> S.D. Cal. Superseding Indict. filed June 19, 2012.

<sup>76</sup> S.D. Cal. Judgment dated May 22, 2013.

scams are among the top ten fraud schemes used by criminals to target seniors.<sup>77</sup> TIGTA's Office of Investigations investigated an individual who, along with his co-conspirators, engaged in a fraud scheme that specifically targeted senior citizens. As part of the scheme, a co-conspirator sent e-mails to victims representing that he was an attorney or foreign government official who was responsible for distributing an inheritance. The e-mails sent to the unsuspecting victims falsely informed them that they owed additional taxes to the IRS, or had inherited millions of dollars but needed to pay processing fees to release the funds. When the victims responded to the e-mails, the subject of the investigation, or one of his co-conspirators, contacted them by telephone and e-mail pretending to be someone who could assist them in obtaining the promised inheritance. The victims were led to believe that these contacts were from legitimate business people, and were deceived into paying fees in advance of receiving the inheritance. However, the funds were never used to pay any fees, nor were any inheritance payments made to the victims. The subject of this investigation was sentenced to 10 years in prison<sup>78</sup> after pleading guilty to an indictment charging him with 15 counts of wire fraud.<sup>79</sup>

### Tax Refund Fraud

#### *Verification of Income and Withholding*

Access to third-party income and withholding information at the time tax returns are processed is the most important tool the IRS could use to detect and prevent tax fraud resulting from the reporting of false income and withholding. While the IRS has increased its detection of fraudulent tax returns at the time tax returns are processed and has prevented the issuance of billions of dollars in fraudulent tax refunds, it still does not have timely access to third-party income and withholding information needed to make any substantial improvements in its detection efforts.

Expanded access to the National Directory of New Hires could immediately provide the IRS with this type of information that could help prevent tax fraud. Currently, the IRS's use of this information is limited by law to just those tax returns that include a claim for the EITC. The IRS has included a legislative proposal for expanded access to this information in its annual budget submissions for FYs 2010 through 2013

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<sup>77</sup> *Top Ten Scams Targeting Seniors*, National Council on Aging, <http://www.ncoa.org/enhance-economic-security/economic-security-Initiative/savvy-saving-seniors/top-10-scams-targeting.html> (last visited Apr. 4, 2013).

<sup>78</sup> C.D. Cal. Judgment and Probation/Commitment Order filed Oct. 21, 2013.

<sup>79</sup> C.D. Cal. Opposition to Defendant's Ex Parte Application to Continuance of Trial Date filed June 6, 2012; C.D. Cal. Indict. filed Oct. 21, 2009; C.D. Cal. Crim. Complaint filed Aug. 3, 2009; C.D. Cal. Crim. Minutes Change of Plea filed July 31, 2012.

and has once again included this proposal in its FY 2014 budget submission. In an effort to combat identity theft, the Chairman of the Senate Finance Committee proposed in November 2013 granting the IRS authority to use the Department of Health and Human Services (HHS) National Directory of New Hires to verify employment data.

Improvements can also be made to the income and verification processes when tax returns are identified by the IRS as potentially fraudulent. In August 2013, we reported<sup>80</sup> that ineffective income and withholding verification processes are resulting in the issuance of potentially fraudulent tax refunds. Our review of a random sample of 272 tax returns sent for verification found that ineffective verification processes resulted in the issuance of the potentially fraudulent tax refunds associated with these tax returns.

### *Prisoner Fraud*

Refund fraud associated with the use of Social Security Numbers of and by prisoners to file false tax returns remains a significant problem for tax administration. The IRS informed us that the number of fraudulent tax returns identified by the IRS as filed using a prisoner SSN has increased from more than 18,000 tax returns in CY 2004 to more than 186,000 tax returns in CY 2011. The refunds claimed on these tax returns increased from \$68 million to \$3.7 billion.

In December 2010, we reported<sup>81</sup> that significant problems exist with the IRS's efforts to identify the use of Social Security Numbers of and by prisoners to file false tax returns to commit tax refund fraud. The Inmate Tax Fraud Prevention Act of 2008<sup>82</sup> provided the IRS with the authority to disclose prisoner tax information to the Federal Bureau of Prisons. The Homebuyer Assistance and Improvement Act of 2010<sup>83</sup> expanded that authority to include State Departments of Corrections in July 2010. However, as of October 2010, the IRS had not completed the necessary agreements to share prisoner information. As a result, no information had been disclosed to either the Federal Bureau of Prisons or State Departments of Corrections at that time. In January 2013, the American Taxpayer Relief Act of 2012<sup>84</sup> provided the IRS with the permanent

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<sup>80</sup> TIGTA, Ref. No. 2013-40-083, *Income and Withholding Verification Processes are Resulting in the Issuance of Potentially Fraudulent Tax Refunds* (Aug. 2013).

<sup>81</sup> TIGTA, Ref. No. 2011-40-009, *Significant Problems Still Exist With Internal Revenue Service Efforts to Identify Prisoner Tax Refund Fraud* (Dec. 2010).

<sup>82</sup> Pub. L. No. 110-428, 122 Stat. 4839.

<sup>83</sup> Pub. L. No. 111-198, 124 Stat. 1356.

<sup>84</sup> Pub. L. No. 112-240, 126 Stat. 2319 (2013).

authority to share information with the Federal Bureau of Prisons or State Departments of Corrections. As of January 2014, there are still no agreements in place.

We also found that the review process used by the IRS to compile the 2009 prisoner data file<sup>85</sup> lacked managerial oversight to ensure the accuracy and reliability of this file. This omission is critical because the Prisoner File is used by the IRS to identify potentially fraudulent prisoner tax returns at the time a tax return is filed and prior to issuance of the refund. In December 2012, we reported<sup>86</sup> the results of a follow-up review assessing the reliability of the IRS's Prisoner File. We determined that despite increased efforts by the IRS to improve the accuracy of the Prisoner File, there were inaccuracies in the prisoner information, the file contained incomplete records, and not all prisons reported prisoners. As such, the controls used to ensure that the IRS identifies fraudulent refunds on tax returns prepared by prisoners were not fully effective. Most of these issues we identified are beyond the control of the IRS because the IRS has to rely on information provided by the prisons to identify prisoner-filed tax returns. Nonetheless, the IRS can do more to ensure that the Prisoner File is accurate and complete by taking further steps to improve its validation and verification processes. IRS management agreed to continue to assess the effectiveness of the validation activities performed on the Prisoner File. We recently initiated a follow-up review<sup>87</sup> to evaluate the effectiveness of the IRS's corrective actions in response to our prior report to identify and reduce prisoner fraud.<sup>88</sup>

#### *Stolen or Falsely Obtained Employer Identification Numbers*

Individuals attempting to commit tax refund fraud commonly steal or falsely obtain an EIN to file tax returns reporting false income and withholding. A valid EIN for the employer must be provided in support of wages and withholding reported on individual tax returns. Individuals who report wages and withholding on a tax return must attach a Form W-2, *Wage and Tax Statement*,<sup>89</sup> to a paper-filed tax return to support the income and withholding reported. For an e-filed tax return, the filer must input the information from the Form W-2 into the e-filed tax return.

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<sup>85</sup> The IRS annually compiles a list of prisoners (Prisoner Data File) from the Federal Bureau of Prisons and State Departments of Corrections. Various IRS offices and functions use the Prisoner File to prevent and detect fraud committed by prisoners, including the filing of fraudulent tax returns.

<sup>86</sup> TIGTA, Ref. No. 2013-40-011, *Further Efforts Are Needed to Ensure the Internal Revenue Service Prisoner File is Accurate and Complete* (Dec. 2012).

<sup>87</sup> TIGTA, Audit No. 201340016, *Prisoner Fraud – Follow-Up*, report planned for May 2014.

<sup>88</sup> TIGTA, Ref. No. 2011-40-009, *Significant Problems Still Exist With Internal Revenue Service Efforts to Identify Prisoner Tax Refund Fraud* (Dec. 2010).

<sup>89</sup> The IRS requires employers to report wage and salary information for employees on a Form W-2. The Form W-2 also reports the amount of Federal, State, and other taxes withheld from an employee's paycheck.



TIGTA identified 767,071 TY 2011 e-filed individual tax returns with refunds based on falsely reported income and withholding using a stolen or falsely obtained EIN.<sup>90</sup> TIGTA estimates that the IRS could issue almost \$2.3 billion annually in potentially fraudulent tax refunds based on these EINs. There were 285,670 EINs used on these tax returns:

- 277,624 were stolen EINs used to report false income and withholding on 752,656 tax returns with potentially fraudulent refunds issued totaling more than \$2.2 billion.
- 8,046 were falsely obtained EINs used to report false income and withholding on 14,415 tax returns with potentially fraudulent refunds issued totaling more than \$50 million.

These 767,071 returns with potentially fraudulent refunds issued is in addition to the approximately 1.2 million undetected TY 2011 tax returns we identified as having characteristics of an identity theft tax return discussed earlier in our testimony.

The IRS has developed a number of processes to prevent fraudulent refunds claimed using stolen and falsely obtained EINs. As previously noted, third-party information is not available to effectively detect the reporting of false income and withholding at the time tax returns are processed. Nonetheless, the IRS has both tax information and other data that can be used to proactively identify tax returns with income reported using a stolen or falsely obtained EIN. Using these data, the IRS could have identified 53,169 tax returns with refunds issued totaling almost \$154 million that had income reported with a stolen or falsely obtained EIN. IRS management agreed with our recommendation to update fraud filters using the tax information and other data we identified.

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<sup>90</sup> TIGTA, Ref. No. 2013-40-120, *Stolen and Falsely Obtained Employer Identification Numbers Are Used to Report False Income and Withholding* (Sep. 2013).

## IMPLEMENTATION OF THE AFFORDABLE CARE ACT

The Patient Protection and Affordable Care Act<sup>91</sup> and the Health Care and Education Reconciliation Act of 2010 (Affordable Care Act) contains an extensive array of tax law changes that will present many challenges for the IRS in the coming years. The ACA provisions provide incentives and tax breaks to individuals and small businesses to offset health care expenses. They also impose penalties, administered through the tax code, for individuals and businesses that do not obtain health care coverage for themselves or their employees. The ACA represents the largest set of tax law changes in more than 20 years and represents a significant challenge to the IRS.

### *ACA-related Customer Service*

In December 2013, we issued a report on the IRS's ACA customer service strategy,<sup>92</sup> which is a collaborative and coordinated effort between the IRS and multiple Federal and State agencies. The Department of Health and Human Services will serve as the "public face" for customer service at the Exchanges<sup>93</sup> until Calendar Year 2015. Individuals who contact the IRS for ACA assistance will be referred to the HHS's public website (Healthcare.gov) and toll-free telephone assistance lines. The IRS will also refer individuals to its own recorded telephone messages and self-assistance tools. In CY 2015, the IRS will take the lead in providing customer service when individuals begin filing their 2014 tax returns. The IRS's customer service strategy includes sufficient plans to: 1) perform outreach and education; 2) update or develop tax forms, instructions, and publications; and 3) provide employee training to assist individuals in understanding the requirement to maintain minimum essential coverage and the tax implications of obtaining the Premium Tax Credit.

However, changes in the implementation of ACA tax provisions may result in increased demand for customer service assistance resulting in more contacts with the IRS. Depending on the nature of any changes made to ACA tax provisions, the IRS's strategy and plans to provide adequate customer service could be affected. In an attempt to mitigate the effect that implementation changes may have on its ability to provide adequate customer service, the IRS has developed oversight and monitoring

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<sup>91</sup> Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified as amended in scattered sections of U.S. Code), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029.

<sup>92</sup> TIGTA, Ref. No. 2014-43-006, *Affordable Care Act: The Customer Service Strategy Sufficiently Addresses Tax Provisions; However, Changes in Implementation Will Create Challenges* (Dec. 2013).

<sup>93</sup> Exchanges are intended to allow eligible individuals to obtain health insurance, and all Exchanges, whether State-based or established and operated by the Federal government, will be required to perform certain functions.

processes and procedures to alert management at the earliest possible time of actions that may affect its operations.

#### *Security Over Federal Tax Data*

The information technology and security challenges for the ACA are considerable and include implementation of interdependent projects in a short span of time, evolving requirements, coordination with internal and external stakeholders, cross-agency system integration, and testing. ACA implementation will have a significant impact on existing systems, so there must be bandwidth to support all provisions. Finally, projects must be staffed with personnel who have the required knowledge and skills to efficiently deploy new technologies. To manage these challenges, the IRS created a Project Management Office for the ACA within the Information Technology program area.

The Exchanges will request income and family size information for each applicant and their family members who are qualified to apply for health insurance and will forward the request to the IRS. The Department of Health and Human Services Data Services Hub provides the connections for the Exchanges and all other Federal agencies, including the IRS.

The IRS, using Federal tax data, will determine the applicant's historical household income, family size, filing status, adjusted gross income, taxable Social Security benefits, and other requested information. The IRS will then transmit the Federal tax data to the HHS Data Services Hub for delivery to the appropriate Exchange. The Exchanges will compare the IRS information with the information provided by the applicant and other available data.

TIGTA issued a report on the IRS Income and Family Size Verification Project and found that the project was on schedule and the IRS was managing known information technology risks at the time the audit was conducted.<sup>94</sup> TIGTA recommended that the IRS: 1) improve the management of ACA changes to requirements; and 2) use an integrated suite of automated tools to manage ACA requirements and application test cases.

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<sup>94</sup> TIGTA, Ref. No. 2013-23-034, *Affordable Care Act: The Income and Family Size Verification Project: Improvements Could Strengthen the Internal Revenue Service's New Systems Development Process* (Mar. 2013).

TIGTA remains concerned about the protection of confidential taxpayer data that will be provided to the Exchanges. The Federal tax data provided to HHS and the Exchanges will be protected through the IRS's Safeguard Review Program. TIGTA is currently conducting an audit of the IRS's Safeguard Review Program and will issue a report on its operations in Fiscal Year 2014.<sup>95</sup> TIGTA has concerns that the Safeguard Review Program may lack sufficient staffing or funding to adequately expand its operations to include the addition of the Federal and State Exchanges.

*Protection Against Fraudulent ACA Claims on Tax Returns*

The Exchanges will use the income and family size information received from the IRS as well as information provided by the applicant and other data sources in finalizing the income amounts and family size. TIGTA is currently evaluating the accuracy of the data that the IRS provides to the HHS for use in enrolling individuals and calculating the Advanced Premium Tax Credit, and plans to issue a report this year.<sup>96</sup> We plan to assess the protection of Federal tax data provided by the Program in the future.<sup>97</sup>

There could be many reasons why the Credit originally claimed by the taxpayer is different when the tax return is filed. For example, the taxpayer's income could have changed from the prior year when he or she applied for health coverage, or the taxpayer's family size may have increased or decreased from the prior year.

TIGTA is concerned that the potential for refund fraud and related schemes could increase as a result of processing ACA Premium Tax Credits unless the IRS builds, implements, updates, and embeds ACA predictive analytical fraud models into its tax filing process.

The IRS has developed a plan to prevent, detect, and resolve fraud and abuse during ACA tax return processing. The plan, when fully developed and implemented, is designed to leverage third-party reporting from the Exchanges and new computer analytical capability built into the Return Review Program.<sup>98</sup> The plan calls for the

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<sup>95</sup> TIGTA, Audit No. 201320029, *Review of the Internal Revenue Service's Office of Safeguards*, report planned for April 2014.

<sup>96</sup> TIGTA, Audit No. 201340335, *Affordable Care Act: Accuracy of the Income and Family Size Verification and Advanced Premium Tax Credit Calculation*, report planned for May 2014.

<sup>97</sup> TIGTA, Audit No. 201420302, *Security Over Federal Tax Data at Health Insurance Exchanges*, report planned for August 2014.

<sup>98</sup> The Return Review Program is the key automated component of the IRS's pre-refund initiative and will implement the IRS's new business model for a coordinated criminal and civil tax noncompliance approach to prevent, detect, and resolve tax refund fraud, including refundable ACA premium tax credits.

development of the ACA Validation Service which will be used to identify improper ACA-related refunds. The ACA Validation Service will be designed to perform screening for improper refunds and will also identify fraudulent schemes that include multiple returns. The IRS plans to rely on the Electronic Fraud Detection System and/or the new Return Review Program to provide the systems to identify and prevent ACA-related refund fraud.

The applications for processing electronic and paper tax returns will need to be modified before January 2015 in order to be able to use the new ACA Validation Service to determine if a taxpayer claiming the Premium Tax Credit also purchased insurance through the Exchanges or received an Advanced Premium Tax Credit in 2014, and if any math errors exist.

TIGTA performed a system development audit of the Return Review Program<sup>99</sup> and determined that roles for program-level governance were not yet established for the Return Review Program, and that the key role of system integrator was not documented or clearly communicated. As a result, there is limited assurance that Return Review Program systems development activities will achieve expected benefits or meet time-sensitive business and information technology requirements for addressing the IRS's evolving tax refund fraud risks.

#### *ACA Provisions Impacting the Current 2014 Filing Season*

Several ACA tax-related provisions became effective for CY 2013 that affect individuals with high incomes including the creation of a new net investment income tax,<sup>100</sup> and an increase in the employee-share of the Medicare tax (i.e., Hospital tax).<sup>101</sup> The ACA also increased the income limit for qualifying medical and dental expenses taken as an itemized deduction. In prior years, individuals could take an itemized deduction for qualified medical and dental expenses that exceeded 7.5 percent of their Adjusted Gross Income. Beginning in Calendar Year 2013, the qualifying expenses must exceed 10 percent of Adjusted Gross Income.

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<sup>99</sup> TIGTA, Ref No. 2013-20-063, *Improvements Are Needed to Ensure Successful Development and System Integration for the Return Review Program* (July 2013).

<sup>100</sup> The ACA created a new tax that is equal to 3.8 percent of an individual's net investment income for the tax year or the excess of the individual's Modified Adjusted Gross Income over \$200,000 (\$250,000 for married individuals filing jointly).

<sup>101</sup> The ACA increased the employee-share of the Medicare tax to 0.9 percent of an individual's covered wages in excess of \$200,000 (\$250,000 for married individuals filing jointly). The ACA also increased the Medicare tax on self-employment income to 0.9 percent of an individual's self-employment income over \$200,000 (\$250,000 for married individuals filing jointly).

Taxpayers will begin filing tax returns with these tax changes during the 2014 Filing Season. In addition to reprogramming its computer systems to properly reflect these changes, the IRS had to issue guidance to taxpayers and tax return preparers explaining each of these provisions and revise or develop new tax forms, instructions and publications to reflect the tax law changes. We have a review ongoing to determine if the IRS has correctly implemented these provisions, which includes analyzing tax returns to ensure that they are accurately processed.<sup>102</sup>

## IRS TAX GAP

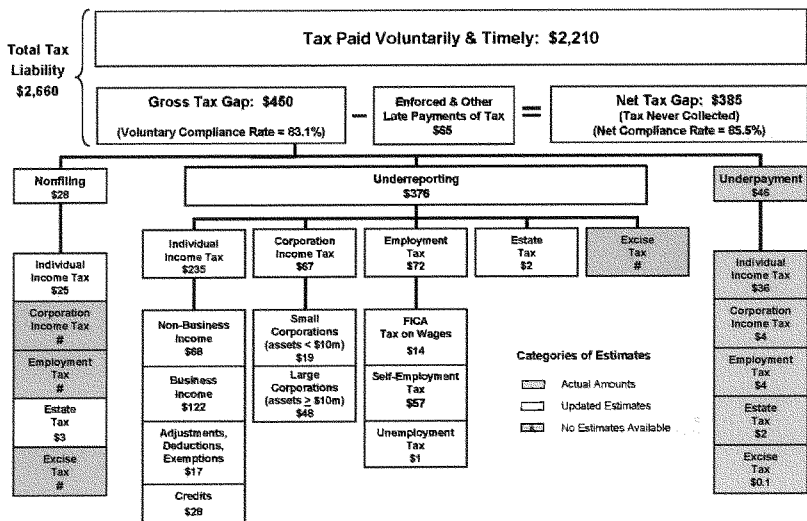
A serious challenge confronting the IRS is the Tax Gap, which is defined as the difference between the estimated amount taxpayers owe and the amount they voluntarily and timely pay for a tax year. The most recent gross Tax Gap estimate developed by the IRS was \$450 billion for TY 2006, which is an increase from the prior estimate of \$345 billion for TY 2001. The voluntary compliance rate<sup>103</sup> decreased slightly from 83.7 percent in 2001 to 83.1 percent in 2006. Figure 1 shows the IRS's latest Tax Gap Map illustrating the various components of the Tax Gap.

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<sup>102</sup> TIGTA, Audit No. 201440014, *2014 Filing Season Implementation*, report planned for September 2014.

<sup>103</sup> The voluntary compliance rate is an estimate of the amount of tax for a given year that is paid voluntarily and timely.

**Figure 1**  
**Tax Gap “Map”**  
**Tax Year 2006 (\$ billions)**



Internal Revenue Service, December 2011

The largest component (approximately 84 percent) of the Tax Gap is based on taxpayers' underreporting taxes due. The IRS addresses this gap by attempting to identify questionable tax returns when they are received and processed and by conducting examinations of tax returns filed to determine if there are any adjustments needed to the information reported on the tax returns. Additional taxes are assessed and collected.

The next component (10 percent) of the Tax Gap is based on taxpayers underpaying taxes due. The IRS addresses this gap by issuing notices and contacting taxpayers to collect the delinquent taxes. The IRS is authorized to take enforcement action, such as filing liens and seizing assets, to collect the taxes.

The smallest component (6 percent) of the Tax Gap is based on taxpayers who do not file tax returns when they are due. This component also may not have taxes withheld or make estimated taxes. The IRS analyzes data from third parties (such as Forms W-2 or Forms 1099) to identify taxpayers who should have filed a tax return, and either prepares a substitute tax return or contacts the taxpayer to obtain the delinquent

tax return.

The scope, complexity, and magnitude of the international financial system also presents significant enforcement challenges for the IRS. At the end of CY 2012, foreign business holdings and investments in the United States were \$25.5 trillion, an increase of nearly \$135 billion over CY 2011, while U.S. business and investments abroad grew to over \$21.6 trillion, an increase of nearly \$1.5 billion during the same period. The numbers of taxpayers conducting international business transactions continues to grow as technological advances provide opportunities for offshore investments that were once only possible for large corporations and wealthy individuals.

As advancing technology continues to allow more cross-border transactions, the IRS is increasingly challenged by a lack of information reporting on many of them. In addition, the varying legal requirements imposed by different jurisdictions lead to the creation of complex business structures that are not easy to understand, making the determination of the full scope and effect of cross-border transactions extremely difficult.

As this global economic activity increases, so do concerns regarding the International Tax Gap.<sup>104</sup> While the IRS has not developed an accurate and reliable estimate of the International Tax Gap, non-IRS sources estimate it to be between \$40 billion and \$133 billion annually. To address the International Tax Gap, the IRS developed an international tax strategy plan with two major goals: (1) to enforce the law to ensure that all taxpayers meet their obligations and (2) to improve service to make voluntary compliance less burdensome.

The IRS also currently faces the challenge of implementing the *Foreign Account Tax Compliance Act* (FATCA).<sup>105</sup> FATCA was enacted to combat tax evasion by U.S. persons holding investments in offshore accounts. Under this Act, a U.S. taxpayer with financial assets outside the United States will be required to report those assets to the IRS. In addition, foreign financial institutions will be required to report to the IRS certain information about financial accounts held by U.S. taxpayers or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. The IRS is developing a new international system, the Foreign Financial Institution Registration System, to support the requirements of FATCA. This system is intended to register foreign financial institutions to assist in achieving the primary objective of FATCA which is the disclosure of U.S. taxpayer foreign accounts. TIGTA reviewed the development of this

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<sup>104</sup> Taxes owed but not collected on time from a U.S. person or foreign person whose cross-border transactions are subject to U.S. taxation.

<sup>105</sup> Pub. L. No. 111-147, Subtitle A, 124 Stat 71, \*96-116 (2010) (codified in scattered sections of 26 U.S.C.).



system and reported that the program management control processes did not timely identify or communicate system design changes to ensure its successful deployment.<sup>106</sup>

Concerns about the International Tax Gap have also led to increased enforcement efforts on international information reporting requirements and increased assessments of related penalties. For example, the IRS has automated the penalty-setting process for the Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*, which has resulted in a total of \$215.4 million in late-filed Form 5471 penalty assessments during FYs 2009 through 2012.<sup>107</sup>

In addition, the IRS established the International Campus Compliance Unit to expand its audit coverage of tax returns with international aspects and to increase compliance among international individual taxpayers. For FY 2011 through March 13, 2013, the Campus Compliance Unit conducted almost 18,000 audits and assessed approximately \$36 million in additional tax. Despite its accomplishments, TIGTA found that the Campus Compliance Unit has no specific performance measures for its operations.<sup>108</sup>

We reviewed enforcement revenue trends and noted that in FY 2007, the IRS collected over \$59 billion in taxes, penalties and interest, but the dollars collected dropped over the next two years before increasing again in FY 2010. Subsequently, dollars collected decreased to slightly more than \$50 billion in FY 2012. While the IRS did not track the reason for the increase in FY 2010, it did receive additional funds to hire over 1,500 revenue officers from June 2009 to February 2010.

One enforcement program whose resources have been significantly reduced is the Automated Collection System (ACS). The ACS function attempts to collect taxes through telephone contact with taxpayers before cases are assigned to revenue officers who make in-person visits to collect delinquent taxes. The ACS has 16 call sites in the Small Business and Self Employed Division and Wage and Investment Division. However, ACS staff was reduced from 2,824 contact representatives in FY 2010 to 2,140 (24 percent) contact representatives in FY 2013. In addition, three call sites were taken off-line in February 2013 to work Accounts Management inventory (other than identity theft cases) because Accounts Management began devoting more of its

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<sup>106</sup> TIGTA Ref. No. 2013-20-118, *Foreign Account Tax Compliance Act: Improvements Are Needed to Strengthen Systems Development for the Foreign Financial Institution Registration System* (Sept. 2013).

<sup>107</sup> TIGTA, Ref. No. 2013-30-111, *Systemic Penalties on Late-Filed Forms Related to Certain Foreign Corporations Were Properly Assessed, but the Abatement Process Needs Improvement* (Sept. 2013).

<sup>108</sup> TIGTA, Ref. No. 2013-30-113, *The International Campus Compliance Unit Is Improving Individual Tax Compliance* (Sept. 2013).

resources to work the growing inventory of identity theft cases. This shift in resources to Accounts Management was originally scheduled to continue for three months but was subsequently extended through the end of FY 2013 and was still ongoing as of February 2014. As a result of these combined reductions, the number of ACS contact representatives in FY 2013 was 41 percent less than in FY 2010.

Another impact on the ACS program is how resources are applied to its growing workload. In FY 2013, the ACS prioritized answering telephone phone calls from taxpayers over working delinquent accounts, which resulted in the ACS spending only 24 percent of its resources on working inventory and 76 percent on answering taxpayers' questions. The shift from working inventory has had consequences on the ACS's core mission of collecting delinquent taxes. In an ongoing audit, we reviewed ACS business results from FY 2010 through FY 2013 and determined:

- New inventory is outpacing closures, so the inventory is growing.
- Inventory is taking longer to close, and the cases are older.
- When cases are closed, more are closed as currently not collectible.
- Fewer enforcement actions are taken.
- More, and older, cases are being transferred to the growing inventory of cases available to be assigned Collection Field personnel.<sup>109</sup>

Leveraging external resources, such as whistleblowers, can help improve tax compliance. The IRS Whistleblower Program also plays an important role in reducing the Tax Gap and maintaining the integrity of a voluntary tax compliance system. However, TIGTA reported that the program continued to have internal control weaknesses when processing whistleblower claims. For example, information captured from multiple systems and entered into a single inventory control system was potentially inaccurate, and the quality review process for the new inventory system was not sufficient to ensure that claims were accurately controlled. Additionally, TIGTA determined that timeliness standards for processing claims were not sufficient. Without adequate oversight of the Whistleblower Program, the IRS is not as effective as it could be in responding timely to tax noncompliance issues.<sup>110</sup>

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<sup>109</sup> TIGTA, Audit No. 201330017, *Review of the Automated Collection System Inventory Management*, report planned for May 2014.

<sup>110</sup> TIGTA, Ref. No. 2012-30-045, *Improved Oversight Is Needed to Effectively Process Whistleblower Claims* (Apr. 2012).

Modernizing information systems could potentially allow the IRS to post more comprehensive tax return information to its computer systems, which could facilitate the examination process and expedite taxpayer contacts for faster resolution.

The IRS considers the Customer Account Data Engine 2 (CADE 2) program to be critical to its mission and it is the IRS's most important information technology investment. TIGTA reported that the implementation of CADE 2 daily processing allowed the IRS to process tax returns for individual taxpayers more quickly by replacing existing weekly processing.<sup>111</sup> The CADE 2 system also provides for a centralized database of individual taxpayer accounts, which will allow IRS employees to view tax data online and provide timely responses to taxpayers once it is implemented. The IRS's modernization efforts also include developing computer programs to conduct predictive analytics to reduce refund fraud.<sup>112</sup> The successful implementation of the IRS's modernization program should significantly improve service to taxpayers and enhance Federal tax administration.

Simplifying the tax code could help taxpayers understand and voluntarily comply with their tax obligations and limit opportunities for tax evasion.

Finally, penalties are an important tool because they discourage taxpayer behavior that contributes to the Tax Gap. Congress provided numerous penalty provisions in the Internal Revenue Code that the IRS can use to help remedy the noncompliance that contributes to the Tax Gap. The IRS can assess accuracy-related penalties for negligence, substantial understatement of income tax, or substantial valuation misstatement. The IRS estimated that the underreporting of tax contributed \$376 billion (84 percent) of the \$450 billion total gross Tax Gap, including \$235 billion from individual income taxes. To deter this type of behavior, the IRS reported during FY 2011 it assessed over 500,000 accuracy-related penalties, involving over \$1 billion against individuals.

## **MANAGEMENT ACTIONS IN RESPONSE TO PRIOR REPORTED ISSUES**

TIGTA follows up regularly on management actions in response to recommendations in our reports. Two notable examples that we are currently following up on are the reports on Exempt Organizations and IRS spending on conferences.

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<sup>111</sup> TIGTA, Ref. No. 2012-20-122, *Customer Account Data Engine 2 System Requirements and Testing Processes Need Improvements* (Sep. 2012).

<sup>112</sup> Computer models that analyze extremely large quantities of data to seek out data patterns and relationships that could indicate potential tax fraud schemes.

TIGTA previously reported<sup>113</sup> that the IRS used inappropriate criteria for selecting and reviewing applications for tax-exempt status. This resulted in substantial delays in processing certain applications and unnecessary information requests being issued to certain organizations.

The IRS Commissioner reported in January 2014 that the IRS completed action on all nine recommendations contained in our May 2013 report. TIGTA is currently assessing the actions the IRS has taken in response to our recommendations.<sup>114</sup>

In its response to our report on conference spending,<sup>115</sup> IRS management agreed with all of our recommendations. Since the issuance of our report, the IRS has addressed many of our recommendations with interim guidance that it plans to formalize through updates to the Internal Revenue Manual.<sup>116</sup> Once the IRS finalizes its guidance, TIGTA plans to conduct a follow-up audit to determine if controls implemented by the IRS address the recommendations we made.

We at TIGTA take seriously our mandate to provide independent oversight of the IRS in its administration of our Nation's tax system. As such, we plan to provide continuing audit coverage of the IRS's efforts to operate efficiently and effectively and investigate any instances of IRS employee misconduct. I hope my discussion of some of the major challenges facing the IRS assists Congress in ensuring accountability over the IRS.

Chairman Crenshaw, Ranking Member Serrano, and Members of the Subcommittee, thank you for the opportunity to share my views.

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<sup>113</sup> TIGTA, Ref. No. 2013-10-053, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review* (May 2013).

<sup>114</sup> TIGTA, Audit No. 201410009, *Status of Actions to Improve Identification and Processing of Applications for Tax-Exempt Status – Follow-Up*.

<sup>115</sup> TIGTA, Ref. No. 2013-10-037, *Review of the August 2010 Small Business/Self-Employed Division's Conference in Anaheim, California* (May 2013).

<sup>116</sup> The Internal Revenue Manual is the primary official source of IRS instructions to staff that relate to the administration and operation of the IRS.



## **J. Russell George**

### **Treasury Inspector General for Tax Administration**

Following his nomination by President George W. Bush, the United States Senate confirmed J. Russell George in November 2004, as the Treasury Inspector General for Tax Administration. Prior to assuming this role, Mr. George served as the Inspector General of the Corporation for National and Community Service, having been nominated to that position by President Bush and confirmed by the Senate

in 2002.

A native of New York City, where he attended public schools, including Brooklyn Technical High School, Mr. George received his Bachelor of Arts degree from Howard University in Washington, DC, and his Doctorate of Jurisprudence from Harvard University's School of Law in Cambridge, MA. After receiving his law degree, he returned to New York and served as a prosecutor in the Queens County District Attorney's Office.

Following his work as a prosecutor, Mr. George joined the Counsel's Office in the White House Office of Management and Budget where he was Assistant General Counsel. In that capacity, he provided legal guidance on issues concerning presidential and executive branch authority. He was next invited to join the White House Staff as the Associate Director for Policy in the Office of National Service. It was there that he implemented the legislation establishing the Commission for National and Community Service, the precursor to the Corporation for National and Community Service. He then returned to New York and practiced law at Kramer, Levin, Naftalis, Nessen, Kamin & Frankel.

In 1995, Mr. George returned to Washington and joined the staff of the Committee on Government Reform and Oversight and served as the Staff Director and Chief Counsel of the Government Management, Information and Technology subcommittee (later renamed the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations), chaired by Representative Stephen Horn. There he directed a staff that conducted over 200 hearings on legislative and oversight issues pertaining to Federal Government management practices, including procurement policies, the disposition of government-controlled information, the performance of chief financial officers and inspectors general, and the Government's use of technology. He continued in that position until his appointment by President Bush in 2002.

In addition to his duties as the Inspector General for Tax Administration, Mr. George serves as a member of the Recovery Accountability and Transparency Board, a non-partisan, non-political agency created by the American Recovery and Reinvestment Act of 2009 to provide unprecedented transparency and to detect and prevent fraud, waste, and mismanagement of Recovery funds. There, he serves as chairman of the Recovery.gov committee, which oversees the dissemination of accurate and timely data about Recovery funds.

Mr. George also serves as a member of the Integrity Committee of the Council of Inspectors General for Integrity and Efficiency (CIGIE). CIGIE is an independent entity within the executive branch statutorily established by the Inspector General Act, as amended, to address integrity, economy, and effectiveness issues that transcend individual Government agencies; and increase the professionalism and effectiveness of personnel by developing policies, standards, and approaches to aid in the establishment of a well-trained and highly skilled workforce in the offices of the Inspectors General. The CIGIE Integrity Committee serves as an independent review and investigative mechanism for allegations of wrongdoing brought against Inspectors General.

Mr. CRENSHAW. Ms. Olson.

Ms. OLSON. Chairman Crenshaw, Ranking Member Serrano, and distinguished members of the subcommittee, thank you for holding this hearing and inviting me to testify today.

As you know, the IRS has faced some significant management and funding challenges over the last year. In my written testimony, I have outlined both the IRS's progress and my continuing concerns regarding exempt-organization applications and implementation of the Affordable Care Act. Today, I will focus on four other areas of particular concern.

First, I believe it is critical that we adopt a taxpayer bill of rights. From time to time, the IRS, which is fundamentally an enforcement agency, will do things that are administratively convenient for itself but not fair to taxpayers. In fact, in the preface of my June report to Congress, I analyzed the IRS's actions in dealing with organizations seeking tax-exempt status under 501(c)(4) in the context of the 10 rights I have proposed, and I concluded the IRS's actions would have violated eight of those rights.

The enactment of a taxpayer bill of rights constitutes one important step to prevent similar situations from arising in the future. I am pleased that the House of Representatives passed the bill of rights I have proposed on a voice vote last summer, and I hope the Senate acts, too, because I think that the taxpayer bill of rights should have the force of law. But the IRS itself has the authority to adopt the taxpayer bill of rights, and in case the Senate does not act, I have been working with the IRS leadership to try to get agreement to do so.

Second, I am deeply concerned about the decline in the IRS's ability to meet the service needs of the taxpaying public. Even with the widespread use of tax preparers, the IRS received more than 109 million telephone calls on its customer service lines last year. Among taxpayers seeking to talk to a live assister, the IRS could not answer two out of every five calls, and those taxpayers who got through had to wait an average of 17.6 minutes on hold.

For the first 4 months of the current fiscal year, the IRS is running behind last year's pace. And to make matters worse, the IRS has announced it will only answer basic tax law questions on its phone lines and in its walk-in sites until April 15th and then no—I repeat, no—tax law questions at all after April 15th, including questions from the millions of taxpayers who obtain filing extensions and prepare their returns later in the year.

In the light of events of the past year, I understand that calls for more IRS funding may meet with skepticism, but I must tell you that I don't see any way the agency can begin to meet taxpayer needs without more funding. At the end of the day, IRS funding reductions don't punish the IRS; instead, they punish the nearly 150 million individual taxpayers and more than 10 million business-entity taxpayers who are trying their best to comply with the monstrously complex Tax Code we have imposed on them and who are not receiving the help they need from their government.

Thus, as you start to make funding decisions for fiscal year 2015, I implore you to keep in mind the nearly 20 million phone calls the IRS didn't answer last year, the tens of millions of taxpayers who had to wait on hold for an average of nearly 18 minutes, also after

calling several times, and the IRS's new policy of not answering many tax law questions. If we don't do a better job of assisting taxpayers, noncompliance will increase, and taxpayers and the public fisc will be harmed.

Third, while the IRS is doing a better job of detecting and stopping identity theft and other refund fraud returns, I remain concerned that victims of tax-related identity theft are not being assisted as quickly and as seamlessly as they could. I have recommended for many years that the IRS provide victims with a single employee who would serve as his or her sole contact and who would coordinate crossfunctional work to resolve cases more quickly and painlessly. The IRS should stop dithering and just do this.

Fourth, in my written testimony, I provide a detailed analysis of the sources of Earned Income Tax Credit errors and make practical, concrete proposals for reducing the improper payment rate, even as we ensure that eligible taxpayers are not deterred from receiving the EITC.

These recommendations include emphasizing personal contact during audits, regulating tax preparers to improve return accuracy and protect taxpayers, imposing penalties on preparers who fail to comply with due diligence requirements, using a third-party affidavit form to verify the residence of a child in the EITC audits, and accelerating the use of third-party information reports so the IRS can verify income data before paying out refunds.

This last recommendation will help address identity theft, refund fraud, and improper payments combined—namely, that Congress direct the IRS to develop a plan to enable it to match information return data against tax return data before paying out refunds. At the same time, it could make the data available to taxpayers and thereby help them prepare their returns more accurately and easily.

I appreciate this opportunity to share my thoughts with you, and I would be happy to answer any questions you may have.

Mr. CRENSHAW. Well, thank you very much.

[The information follows:]



**WRITTEN STATEMENT OF**

**NINA E. OLSON**

**NATIONAL TAXPAYER ADVOCATE**

**HEARING ON**

**INTERNAL REVENUE SERVICE OVERSIGHT**

**BEFORE THE**

**SUBCOMMITTEE ON FINANCIAL SERVICES AND GENERAL GOVERNMENT**

**COMMITTEE ON APPROPRIATIONS**

**U.S. HOUSE OF REPRESENTATIVES**

**FEBRUARY 26, 2014**

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Chairman Crenshaw, Ranking Member Serrano, and distinguished Members of this Subcommittee:

Thank you for inviting me to appear today to present my perspective on the key challenges facing the Internal Revenue Service.<sup>1</sup>

The year 2013 was, to say the least, a very challenging one for the IRS. Among other things:

- The IRS's budget was cut for the third year in a row, and because of sequestration, the cuts last year were the most substantial to date. Because of these resource reductions, the IRS's ability to meet the service needs of the taxpaying public was severely impaired, and the agency has made unprecedented and disturbing changes to its delivery of taxpayer service.
- The Treasury Inspector General for Tax Administration (TIGTA) reported that the Exempt Organizations unit had used a "Be on the Lookout" (or "BOLO") list to select applicants with the words "tea party" and other political-sounding names for further review. The IRS initially maintained that such lists were a workload management tool to help identify organizations that were disproportionately likely to engage "primarily" in political activity and therefore be ineligible for exempt status. However, the IRS eventually acknowledged that BOLO lists were a bad idea and banned their use. As a result of this incident, public trust in the fairness and impartiality of the IRS was called into question, and multiple investigations are still underway.
- The 16-day government shutdown affected the IRS's ability to prepare for the tax filing season. As a result, the agency delayed the start of the filing season by 10 days, requiring early filers to wait additional time to receive their tax refunds. During the shutdown, moreover, thousands of taxpayers were exposed to IRS enforcement actions but had no ability to contact IRS employees, including the Taxpayer Advocate Service, all of whose employees were furloughed and unable to assist taxpayers who experienced emergencies caused by ongoing enforcement.<sup>2</sup>

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<sup>1</sup> The views expressed herein are solely those of the National Taxpayer Advocate. The National Taxpayer Advocate is appointed by the Secretary of the Treasury and reports to the Commissioner of Internal Revenue. However, the National Taxpayer Advocate presents an independent taxpayer perspective that does not necessarily reflect the position of the IRS, the Treasury Department, or the Office of Management and Budget. Congressional testimony requested from the National Taxpayer Advocate is not submitted to the IRS, the Treasury Department, or the Office of Management and Budget for prior approval. However, we have provided courtesy copies of this statement to both the IRS and the Treasury Department in advance of this hearing.

<sup>2</sup> During the shutdown from October 1 through October 16, 2013, taxpayers were subject to the following compliance and enforcement actions: 3,902 levies on Social Security benefits; 5,455 levies on financial or other accounts; 7,025 wage levies; 4,099 Notices of Federal Tax Lien issued; 180,095 Automated Underreporter Statutory Notices of Deficiency; and 102,231 Collection Due Process Levy Hearing Notices

Getting the IRS back on track requires not merely strong leadership within the agency, but helpful oversight and support from Congress and other key stakeholders. For that reason, I appreciate your holding today's hearing.

In my view, the IRS is often so focused on resolving immediate crises that it is not able to devote sufficient time to setting long-term goals and developing approaches to achieve those goals. In the preface to my most recent annual report to Congress, I attempted to provide my vision of what a 21<sup>st</sup> century tax administration system should look like.<sup>3</sup> In my testimony today, I will elaborate on the following key issues:

1. **Need for a Taxpayer Bill of Rights.** Congress should enact a thematic, principle-based Taxpayer Bill of Rights.<sup>4</sup> Taxpayers have rights on the service side (e.g., the right to be told what they need to do to comply with the tax laws and the right to have their questions answered) and on the enforcement side (e.g., the right to challenge the IRS's position, the right to designate a representative, and the right to appeal an adverse IRS decision in an independent forum). I have made this recommendation in past reports, and I am very pleased the House of Representatives passed my proposal verbatim last year, with bipartisan support, on a voice vote.<sup>5</sup> Many of the excesses that led up to the IRS Restructuring and Reform Act of 1998 and, as I describe more fully below, many of the IRS actions in dealing with organizations seeking tax-exempt status under IRC § 501(c)(4) in recent years violated the proposed rights. If a Taxpayer Bill of Rights were in place, some of these problems would have been prevented or at least identified and resolved sooner. While I believe a Taxpayer Bill of Rights should have the force of law, and therefore hope the Senate passes this legislation, the IRS has the authority to adopt a Taxpayer Bill of Rights on its own. I have been working with the IRS leadership to try to get agreement to do so.

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issued by the Automated Collection System. Preliminary information from IRS Office of Taxpayer Correspondence, Individual Master File (IMF), and Automated Lien System.

<sup>3</sup> National Taxpayer Advocate 2013 Annual Report to Congress [hereinafter "NTA 2013 Annual Report"], at x.

<sup>4</sup> See NTA 2013 Annual Report 5-19 (Most Serious Problem: *Taxpayer Rights: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration*); NTA 2011 Annual Report 493-518 (Legislative Recommendation: *Enact the Recommendations of the National Taxpayer Advocate to Protect Taxpayer Rights*); NTA 2007 Annual Report 478-489 (Legislative Recommendation: *Taxpayer Bill of Rights and De Minimis "Apology" Payments*).

<sup>5</sup> Taxpayer Bill of Rights Act, H.R. 2768, 113<sup>th</sup> Cong. (2013). In my 2013 report, I suggested some wording modifications, and as discussed below, the Office of the Taxpayer Advocate recently tested our proposed modifications with focus groups of taxpayers and preparers to assess whether the language accurately conveys the gist of the rights we have identified. Based on input from the focus groups, we are currently tweaking the language of a few provisions.

2. **Taxpayer Services and IRS Funding.** The IRS is failing badly at meeting taxpayer needs because it lacks resources.<sup>6</sup> Last year, the IRS received some 109 million telephone calls on its customer service lines. The IRS could answer only 60.5 percent of calls seeking to reach a customer service representative (CSR) – and those taxpayers who got through had to wait an average of 17.6 minutes on hold. Initial statistics for fiscal year (FY) 2014 indicate service has declined even more, with taxpayers waiting an average of more than 20 minutes and tax practitioners kept on hold for more than half an hour.<sup>7</sup> The tax collector is rarely the government's most popular agency, and the revelations that the IRS had used BOLO lists to screen applicants for exempt status further undermined support for the agency. But at the end of the day, IRS funding reductions do not punish the IRS nearly as much as they punish the nearly 150 million individual taxpayers and more than 10 million business entity taxpayers who are trying to comply with the tax laws and not receiving the help they need. When the IRS receives 109 million telephone calls, there is no substitute for the funding to hire enough CSRs to answer them. If the IRS does not receive more funding, the IRS will be unable to assist millions of taxpayers seeking assistance from their government to comply with the tax laws.
3. **Update on Exempt Organization Concerns.** The Commissioner should review and implement my recommendations to expand both taxpayer and employee awareness of TAS and taxpayer rights. Shortly after TIGTA issued its report on the BOLO lists, I published a special report that examined systemic factors contributing to the use of questionable screening criteria and processing delays in connection with exempt organization applicants, and offered 16 preliminary recommendations to address them.<sup>8</sup> Subsequently, Acting Commissioner Danny Werfel asked me to provide recommendations specifically to improve taxpayer and employee awareness of TAS, as the IRS function designed to assist taxpayers with IRS problems, and of taxpayer rights generally. I submitted one report on each topic with specific recommendations,<sup>9</sup> but I have not received a

<sup>6</sup> See NTA 2013 Annual Report 20-38 (Most Serious Problem: *IRS Budget: The IRS Desperately Needs More Funding to Serve Taxpayers and Increase Voluntary Compliance*).

<sup>7</sup> IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot and Product Line Detail* reports (week ending Feb. 1, 2014) (showing results for the first four months of FY 2014).

<sup>8</sup> National Taxpayer Advocate, *Special Report: Political Activity and the Rights of Applicants for Tax-Exempt Status* (June 2013), at [www.taxpayeradvocate.irs.gov/userfiles/file/FullReport/Special-Report.pdf](http://www.taxpayeradvocate.irs.gov/userfiles/file/FullReport/Special-Report.pdf).

<sup>9</sup> See National Taxpayer Advocate, *Report in Response to the Acting Commissioner's 30-Day Report: Analysis and Recommendations to Raise Taxpayer and Employee Awareness of the Taxpayer Advocate and Taxpayer Rights* (Aug. 19, 2013), at [www.taxpayeradvocate.irs.gov/userfiles/file/2013FullReport/Analysis-and-Recommendations-to-Raise-Taxpayer-and-Employee-Awareness-of-the-Taxpayer-Advocate-Service-and-Taxpayer-Rights.pdf](http://www.taxpayeradvocate.irs.gov/userfiles/file/2013FullReport/Analysis-and-Recommendations-to-Raise-Taxpayer-and-Employee-Awareness-of-the-Taxpayer-Advocate-Service-and-Taxpayer-Rights.pdf); National Taxpayer Advocate, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration; Recommendations to Raise Taxpayer and Employee Awareness of Taxpayer Rights* (Nov. 4, 2013), at [www.taxpayeradvocate.irs.gov/userfiles/file/2013FullReport/Toward-a-More-Perfect-Tax-System-A-Taxpayer-Bill-of-Rights-as-a-Framework-for-Effective-Tax-Administration.pdf](http://www.taxpayeradvocate.irs.gov/userfiles/file/2013FullReport/Toward-a-More-Perfect-Tax-System-A-Taxpayer-Bill-of-Rights-as-a-Framework-for-Effective-Tax-Administration.pdf).

response from the IRS. Further, on November 29, 2013, the Treasury Department and the IRS requested public comment on a proposed regulation that provides guidance to tax-exempt social welfare organizations on political activities related to candidates that will not be considered to promote social welfare. Neither the IRS nor Treasury shared this proposed regulation with me, my office, or my counsel for comment prior to submitting it to the Federal Register for publication, nor was I consulted during the drafting process. Therefore, I had no opportunity to influence the content of the regulations prior to publication.

4. **Identity Theft and Refund Fraud.** The IRS should establish a meaningful single point of contact for taxpayers who become victims of identity theft. Today, 21 separate units handle different aspects of identity theft, and although the IRS says it has adopted a single point of contact, no employee has the authority to coordinate the entirety of the taxpayer/victim's case if, as is common, more than one of the 21 units is involved. Thus, taxpayers traumatized by the crime of identity theft are forced to navigate the IRS by themselves, increasing their frustration and despair.<sup>10</sup> The IRS also takes much too long to resolve ID theft cases and issue refunds to legitimate taxpayers. The Taxpayer Advocate Service's experience with identity theft cases demonstrates the soundness of our recommendation that the IRS assign one employee to work with the victim from the beginning, and help coordinate resolution of the case (not merely monitor it) when it requires work by multiple units.
5. **Affordable Care Act.** As part of the Affordable Care Act (ACA), the IRS is implementing complicated health care tax provisions. I believe the IRS has acquitted itself well in meeting its initial responsibilities under the ACA. I have concerns about the IRS's approach to addressing taxpayer questions and adequately training employees on the new provisions. In particular, the IRS is not doing enough to educate taxpayers about the importance of updating their information throughout the year with the Exchange if they are receiving a credit. Our office will continue to work with the IRS to ensure that taxpayers are treated properly and fairly in the implementation of the new law. Within TAS, we are also training our employees about taxpayer concerns they are likely to see next year, such as the impact of premium tax credit reconciliation and under- and overpayments, so they will be properly prepared to assist taxpayers.<sup>11</sup>

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<sup>10</sup> See NTA 2013 Annual Report 75-83 (Most Serious Problem: *Identity Theft: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers*).

<sup>11</sup> See generally National Taxpayer Advocate Fiscal Year 2014 Objectives Report to Congress 29 (*TAS Prepares for Implementation of Health Care Provisions*); IRS: *Enforcing Obamacare's New Rules and Taxes: Hearing Before the House Comm. on Oversight & Gov't Reform*, 112<sup>th</sup> Cong. (2012) (statement of Nina E. Olson, National Taxpayer Advocate).

6. **Accelerated Receipt and Use of Third-Party Information Reports.** Congress should direct the IRS to develop a plan to enable it to match information return data against tax return data before paying out refunds.<sup>12</sup> If the IRS could match Forms 1040 against Forms W-2 in a pre-refund environment, it could dramatically reduce improper payments to identity thieves and other perpetrators of refund fraud, including some improper Earned Income Tax Credit claimants. At the same time, it could make the data available to taxpayers and thereby help them prepare their returns more accurately and easily.
7. **Improper Payments in the Earned Income Tax Credit and Other Refundable Credits.** The IRS must perform a delicate balancing act in administering social benefit programs – seeking simultaneously to maximize participation among the eligible population and to minimize improper payments to persons who are not eligible.<sup>13</sup> While the EITC enjoys a higher participation rate than other benefit programs, it also suffers from significant overclaims. The low income taxpayers who claim the credit must navigate complicated eligibility requirements, often while dealing with changing circumstances in their lives. Since 2001, we have made a number of proposals designed to reduce overclaims without deterring participation by eligible taxpayers. These include changes in EITC audit procedures, regulating tax preparers to improve return accuracy and protect taxpayers, imposing penalties on preparers who fail to comply with due diligence requirements, using a third-party affidavit form to verify the residence of a qualified child in EITC audits, and accelerating the use of third-party information reports so the IRS can verify employee income data before paying out refunds (as discussed in more detail above).

## I. Need for a Taxpayer Bill of Rights

Taxpayer rights are central to our tax system and to tax compliance. If taxpayers believe they are treated, or can be treated, in an arbitrary and capricious manner, they will mistrust the system and be less likely to comply voluntarily. If taxpayers have confidence in the fairness and integrity of the tax system, they will be more likely to comply.

<sup>12</sup> See NTA 2013 Annual Report, vol. 2, 67-96 (Analysis: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*). The National Taxpayer Advocate has been recommending this approach since 2009. See National Taxpayer Advocate 2009 Annual Report to Congress 338-345 (Legislative Recommendation: *Direct the Treasury Department to Develop a Plan to Reverse the "Pay Refunds First, Verify Eligibility Later" Approach to Tax Return Processing*).

<sup>13</sup> See Improper Payments in the Administration of Refundable Tax Credits: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means, 112<sup>th</sup> Cong. (2011) (statement of Nina E. Olson, National Taxpayer Advocate), at [www.irs.gov/pub/irs-utl/testimony-written-wm\\_oversight-improper\\_payments-5-25-2011.pdf](http://www.irs.gov/pub/irs-utl/testimony-written-wm_oversight-improper_payments-5-25-2011.pdf).

The good news on this front is that the Internal Revenue Code provides dozens of taxpayer rights. The bad news is that most taxpayers have no idea what their rights are and therefore often cannot take advantage of them. That is because taxpayer rights are scattered throughout the code and are not presented in a coherent way. Not surprisingly, in response to a taxpayer survey conducted for our office in 2012, less than half of all U.S. taxpayers said they believed they have rights before the IRS, and only 11 percent said they knew what those rights are.<sup>14</sup>

We can and must do a better job of making taxpayers aware of their rights and enabling them to assert them. Since 2007, I have repeatedly recommended adoption of a Taxpayer Bill of Rights that takes the multiple existing rights embedded in the code and groups them into ten broad categories, modeled on the U.S. Constitution's Bill of Rights.<sup>15</sup> Just as the Constitution's Bill of Rights sets out the relationship between the federal government and U.S. citizens and imposes limits on the federal government's power, I believe a thematic, principle-based list of core taxpayer rights would provide a foundational framework for taxpayers and IRS employees alike that would promote effective tax administration. As the National Taxpayer Advocate, I find it wholly unacceptable and deeply concerning that less than half of our taxpayers believe they have rights and only about one out of ten believes they know what their rights are.

The rights we recommend are as follows:

### **Ten Taxpayer Rights**

1. The Right to Be Informed
2. The Right to Quality Service
3. The Right to Pay No More than the Correct Amount of Tax
4. The Right to Challenge the IRS's Position and Be Heard
5. The Right to Appeal an IRS Decision in an Independent Forum
6. The Right to Finality
7. The Right to Privacy

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<sup>14</sup> Forrester Research Inc., *The TAS Omnibus Analysis*, from North American Technographics Omnibus Mail Survey, Q2/Q3 2012 19-20 (Sept. 2012).

<sup>15</sup> Congress has passed several pieces of legislation with "Taxpayer Bill of Rights" in the title. See Technical and Miscellaneous Revenue Act, Pub. L. No. 100-647, § 6226, 102 Stat. 3342, 3730 (1988) (containing the "Omnibus Taxpayer Bill of Rights," also known as TBOR 1); Taxpayer Bill of Rights 2, Pub. L. No. 104-168, 110 Stat. 1452 (1996) (also known as TBOR 2); Internal Revenue Service Restructuring and Reform Act, Pub. L. No. 105-206, 112 Stat. 685 (1998) (Title III is known as "Taxpayer Bill of Rights III" or TBOR 3). These laws create specific rights in certain instances, but they do not create a thematic, principle-based list of overarching taxpayer rights.



8. The Right to Confidentiality

9. The Right to Retain Representation

10. The Right to a Fair and Just Tax System, Including Access to the Taxpayer Advocate Service

In my view, the value of a Taxpayer Bill of Rights can scarcely be overstated. The IRS is largely an enforcement agency, and from time to time, it inevitably will overreach. In the mid-1990s, the IRS employed aggressive collection practices, and in response to numerous taxpayer complaints, Congress passed the IRS Restructuring and Reform Act of 1998 to place significant new limits on collection practices. Many of those practices would have violated the Bill of Rights I have proposed.

Similarly, many of the IRS's recent actions in screening tax exemption applications from "tea party" and other groups violated the rights I have proposed. In my preface to the National Taxpayer Advocate's Fiscal Year 2014 Objectives Report to Congress, I analyzed the IRS's processing of applications for tax-exempt status and showed that the IRS had violated eight of my proposed ten rights.

A Taxpayer Bill of Rights is not a panacea that will prevent all problems or errors in judgment. However, a Taxpayer Bill of Rights would serve as an organizing principle for tax administrators in establishing agency goals and performance measures, provide foundational principles to guide IRS employees in their dealings with taxpayers, and provide information to taxpayers to assist them in their dealings with the IRS.

I am very pleased the House of Representatives passed an earlier version of my Taxpayer Bill of Rights proposal last year with bipartisan support.<sup>16</sup> I believe a TBOR should have the force of law and therefore hope the Senate passes this legislation.

If Congress does not pass this legislation, however, I believe the IRS has the authority to adopt a Taxpayer Bill of Rights on its own. Therefore, I have been working with the IRS leadership to get agreement to do so. I have encountered very few concerns about this proposal. That is because it does not aim to create new rights or remedies – only to group existing rights into categories that are easier for taxpayers and IRS employees to understand and remember. If Congress does not codify a Taxpayer Bill of Rights, I am hopeful the IRS will decide to adopt one in the near future.

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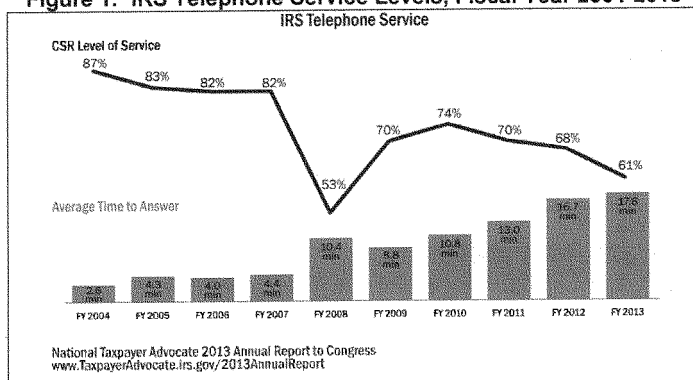
<sup>16</sup> Taxpayer Bill of Rights Act, H.R. 2768, 113<sup>th</sup> Cong. (2013). In my 2013 report, I suggested some wording modifications, and as discussed below, the Office of the Taxpayer Advocate recently tested our proposed modifications with focus groups of taxpayers and preparers to assess whether the language accurately conveys the gist of the rights we have identified. Based on input from the focus groups, we are currently tweaking the language of a few provisions.

## II. Taxpayer Services and IRS Funding

The requirement to pay taxes is generally the most significant burden a government imposes on its citizens. For that reason, I believe the government has a practical and moral obligation to make compliance as simple and painless as possible. Yet the IRS is increasingly unable to meet the service needs of our taxpayers by phone, in person, and by mail. Consider the following:

- Despite the greater availability of information on IRS.gov, the number of telephone calls the IRS receives from taxpayers on its customer service lines has been rising steadily over the past decade – from 71 million calls in FY 2004 to 109 million calls in FY 2013, an increase of 53 percent.<sup>17</sup>
- The IRS lacks the staffing to answer these calls. In FY 2004, the IRS answered 87 percent of calls from taxpayers seeking to speak with a CSR (which, in IRS parlance, is referred to as the “Level of Service” or “LOS”). In FY 2013, the IRS answered only 61 percent of such calls, a reduction of 26 percentage points, or 30 percent, in the LOS. Among those taxpayers lucky enough to get through, hold time increased from 2.6 minutes to 17.6 minutes, a nearly six-fold rise.<sup>18</sup>

**Figure 1: IRS Telephone Service Levels, Fiscal Year 2004-2013**



- The IRS historically has prepared tax returns for low income, elderly, and disabled taxpayers seeking assistance at its walk-in sites (known as “Taxpayer Assistance Centers,” or “TACs”). In FY 2004, the IRS prepared 476,000

<sup>17</sup> IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of FY 2013 and FY 2004).

<sup>18</sup> IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of each fiscal year for FY 2004 through FY 2013).

returns.<sup>19</sup> Since that time, the IRS has imposed increasing limits on return preparation, and by FY 2013, the number of returns it prepared during the filing season had declined by 59 percent as compared with FY 2004.<sup>20</sup>

- The IRS's ability to timely process taxpayer correspondence has also taken a hit. When the IRS sends a taxpayer a notice proposing to increase his or her tax liability, it gives the taxpayer an opportunity to present an explanation or documentation supporting the position taken on the return. Each year, the IRS typically receives around ten million taxpayer responses, known collectively as the "adjustments inventory."<sup>21</sup> The IRS has established timeframes for processing taxpayer correspondence, generally 45 days. During the final week of FY 2004, the IRS failed to process 12 percent of its adjustments correspondence within its timeframes. By contrast, during the final week of FY 2013, the IRS was unable to process 53 percent of adjustments correspondence within these timeframes.<sup>22</sup>

As compared with FY 2013, the IRS's ability to assist taxpayers has suffered further declines in FY 2014:

- For the first four months of FY 2014, the LOS on the phones was 62.5 percent, down from 73.7 percent during the first four months of FY 2013. Among taxpayers who got through, hold time rose from 12.8 minutes to 20.3 minutes. For practitioners calling the Practitioner Priority Service line, the decline was even steeper. The LOS dropped from 81.5 percent to 68 percent, while hold time rose from 12.2 minutes to 32.5 minutes.<sup>23</sup>

<sup>19</sup> This data was provided to TAS by the IRS Wage & Investment Division in connection with the National Taxpayer Advocate's 2007 Annual Report to Congress 162-182 (Most Serious Problem: *Service at Taxpayer Assistance Centers*).

<sup>20</sup> GAO, GAO-14-133, *2013 Tax Filing Season: IRS Needs to Do More to Address the Growing Imbalance between the Demand for Services and Resources* 26 (Dec. 2013); GAO, GAO-11-111, *2010 Tax Filing Season: IRS's Performance Improved in Some Key Areas, but Efficiency Gains Are Possible in Others* 45 (Dec. 2010); GAO, GAO-07-27, *Tax Administration: Most Filing Season Services Continue to Improve, but Opportunities Exist for Additional Savings* 29 (Nov. 2006) (supplemented with IRS data provided to TAS for 2004 through 2006).

<sup>21</sup> In FY 2013, receipts in the Adjustments Inventory were about 8.4 million, as compared with 10.4 million in FY 2012. We are not certain why the number declined. The Adjustments Inventory is one component of the Accounts Management function's overall Paper Inventory. In FY 2013, receipts in the Paper Inventory were about 20.8 million, and the percentage classified as overage at year-end was 47 percent. IRS, Joint Operations Center, *Account Management Information Report (AMIR) – National Summary* (week ending Sept. 28, 2013).

<sup>22</sup> IRS, Joint Operations Center, *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2004 through FY 2013).

<sup>23</sup> IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot and Product Line Detail* reports (week ending Feb. 1, 2014). IRS data for the first four months of the fiscal year (October through January) generally does not include the tax-return filing season, which this year started on January 31.

- In an effort to answer more calls, the IRS posted an announcement on IRS.gov in December that said it will answer only “basic” tax-law questions on its phone lines and in its walk-in sites during the filing season (January through mid-April).<sup>24</sup> It will not answer any questions that are “more detailed” than “basic” during the filing season. Moreover, it will not answer any tax-law questions after mid-April, including “basic” questions from the millions of taxpayers who obtain filing extensions and prepare their returns later in the year.
- Also to conserve resources, the IRS announced that it will no longer prepare any tax returns at its walk-in sites, even for low income, elderly, or disabled taxpayers.<sup>25</sup>

At the risk of vast understatement, it is a sad state of affairs when the government writes tax laws as complex as ours – and then can answer nothing beyond “basic” questions from baffled citizens who are doing their best to comply.

I realize the subject of IRS funding is somewhat controversial for a number of reasons, including the way the IRS screened tax-exemption applications, inappropriate conference spending, and the “Star Trek” parody video. I personally have concerns about IRS performance, and in fact, I am required by statute to be an “IRS critic” by identifying at least 20 of the most serious problems facing taxpayers in my annual reports to Congress.<sup>26</sup> But I must tell you that I do not see any way the agency can begin to meet the service needs of the taxpaying public without substantially more funding. Most notably, almost twenty million phone calls from taxpayers seeking to speak with a customer service representative went unanswered last year. With phone calls up about 17 percent and IRS funding down 8 percent since FY 2010, there is no way the IRS can answer all these calls without more employees.

In part because of mistakes made in the past, the agency has undergone significant leadership changes in recent months. Many policy changes have been made in response to congressional concerns, and the FY 2014 appropriations act contains new directives. If Members have continuing concerns, I encourage you to use the oversight process to try to address them. But I personally believe it is a mistake to cut the IRS’s budget and thereby preclude the agency from providing basic service to tens of millions of taxpayers who seek help each year. When we ask our taxpayers to turn over a significant portion of their incomes to the government, we owe it to them – the constituents you represent, and the taxpayers for whom I advocate – to ensure we have the infrastructure in place to help them comply with the requirements Congress has imposed by law.

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<sup>24</sup> IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), at <http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources>.

<sup>25</sup> *Id.*

<sup>26</sup> See IRC § 7803(c)(2)(B)(ii)(III).

### III. Update on Exempt Organization Concerns

Last June, in a Special Report that accompanied my Fiscal Year 2014 Objectives Report to Congress, I described the management and other failures in the Exempt Organizations (EO) function that led to violations of taxpayers' rights and to the inappropriate activity reported by TIGTA in May of 2013.<sup>27</sup> These failures, affecting taxpayers seeking recognition of exempt status under IRC § 501(c)(4), brought to light both procedural issues (lengthy delays, excessive questioning and document production) and substantive issues (such as the degree to which an entity may engage in political activity and still qualify as an exempt social organization under IRC § 501(c)(4)). As discussed extensively in the Special Report, a number of factors led to the inappropriate handling of these cases, including EO's unfamiliarity with TAS's role and TAS's authority under IRC § 7811. With respect to 19 affected cases in which the taxpayers sought help from TAS, EO was not forthcoming in explaining why their applications for recognition of exempt status were being delayed.

The Special Report contained recommendations to help prevent the problem from recurring and to restore trust with the taxpaying public. I noted that although IRC § 501(c)(4) allows an exemption to an organization "operated *exclusively* for the promotion of social welfare," the Supreme Court in 1945 held only that a non-exempt purpose, "*if substantial in nature*, will destroy the exemption (emphasis added)."<sup>28</sup> Treasury regulations reflect this distinction, and as I noted, "the prevailing legal standard is that an organization formed under IRC § 501(c)(4) may participate in political campaigns as long as it is 'primarily' engaged in social welfare."<sup>29</sup>

The determination as to the sufficiency of an organization's exempt (as opposed to political) purpose is inherently subjective. Because these decisions affect political speech and action, placing the tax agency – which must be apolitical – into the position of making this determination is fraught with risk. To that end, we recommended that Congress clarify the level of political activity that exempt organizations may conduct, and establish an objective test to identify when an organization exceeds that level.<sup>30</sup> On

<sup>27</sup> National Taxpayer Advocate Special Report to Congress: *Political Activity and the Rights of Applicants for Tax-Exempt Status* (June 30, 2013) [hereinafter the Special Report]; TIGTA, Ref. No. 2013-10-053, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review* (May 14, 2013).

<sup>28</sup> *Better Business Bureau of Washington, D.C. v. U.S.*, 326 U.S. 279, 283 (1945).

<sup>29</sup> Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (stating that an "organization is operated *exclusively* for the promotion of social welfare if it is *primarily* engaged in promoting in some way the common good and general welfare of the people of the community (emphasis added);" National Taxpayer Advocate Special Report, at 8.

<sup>30</sup> National Taxpayer Advocate Special Report at 15. Noting that "it may be advisable to separate political determinations from the function of revenue collection," and that the IRS already relies on substantive non-tax determinations from an agency in other situations (see, e.g., IRC § 47 (relating to historic rehabilitation credits certified by the Secretary of the Interior and IRC § 48C (relating to energy credits for which the IRS must consult with the Secretary of Energy regarding certifications)), we also recommended that Congress "[e]xplore the feasibility of requiring the Federal Election Commission or another specialized agency to certify to the IRS that political activity proposed by an applicant for

November 29, 2013, the Treasury Department and the IRS requested public comment on a proposed regulation that provides guidance to tax-exempt social welfare organizations on political activities related to candidates that will not be considered to promote social welfare.<sup>31</sup> Neither the IRS nor Treasury shared this proposed regulation with me, my office, or my counsel for comment prior to submitting it to the Federal Register for publication, nor was I consulted during the drafting process. Therefore, I had no opportunity to influence the content of the regulations prior to publication. I am preparing comments on the proposed guidance, and my staff and I will review comments from others, which are due by February 27, 2014. Additionally, I intend to update my Special Report in June of 2014, providing a follow up on the issues identified in the report and the status of the report's recommendations.

As I noted in the Special Report, other important issues involving exempt organizations have received much less public attention. For example, EO has struggled for years with an inventory backlog of applications for exempt status.<sup>32</sup> The problem has been aggravated by the manner in which EO implemented the provisions in the Pension Protection Act of 2006, which mandated automatic revocation of exempt status for organizations that do not file a return or e-Postcard for three consecutive years.<sup>33</sup> EO required revoked organizations to apply for reinstatement using the same cumbersome Form 1023 used by first-time applicants, and these reinstatement applications added more than 50,000 cases to EO's workload over the past three years.<sup>34</sup>

EO's understaffed Determinations Unit, which processes both first-time and reinstatement applications, now has an inventory backlog of about 66,000 cases, more

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exemption under IRC § 501(c)(4) is not excessive." National Taxpayer Advocate Special Report, 16-17. An example of such an independent regulatory body is the United Kingdom's Charity Commission for England and Wales (<http://www.charitycommission.gov.uk/>).

<sup>31</sup> Notice of Proposed Rulemaking, 78 Fed. Reg. 71535 (Nov. 29, 2013).

<sup>32</sup> I have been reporting on these backlogs and explaining how they burden taxpayers since 2004 (see National Taxpayer Advocate 2004 Annual Report to Congress 193, 203 (Most Serious Problem: *Application and Filing Burdens on Small Tax-Exempt Organizations*). I identified the delay in processing applications for exempt status as among the Most Serious Problems in four of my past seven Annual Reports to Congress, including the most recent (see NTA 2013 Annual Report 165 (Most Serious Problem: *Exempt Organizations: The IRS Continues to Struggle with Revocation Processes and Erroneous Revocations of Exempt Status*); National Taxpayer Advocate 2012 Annual Report to Congress 192 (Most Serious Problem: *Overextended IRS Resources and IRS Errors in the Automatic Revocation and Reinstatement Process Are Burdening Tax-Exempt Organizations*); National Taxpayer Advocate 2011 Annual Report to Congress 442 (Most Serious Problem: *The IRS Makes Reinstatement of an Organization's Exempt Status Following Revocation Unnecessarily Burdensome*); National Taxpayer Advocate 2007 Annual Report to Congress 210 (Most Serious Problem: *Determination Letter Process*).

<sup>33</sup> Section 1223 of the Pension Protection Act of 2006 (Pub. L. No. 109-280, 120 Stat. 780 (2006)) amended IRC § 6033 to impose a new annual reporting requirement, Form 990-N, Electronic Notice (e-Postcard) for Tax-Exempt EOs Not Required to File Form 990 or 990-EZ, on small exempt organizations and mandated automatic revocation of tax-exempt status of organizations that fail to file required returns or e-Postcards for three consecutive years.

<sup>34</sup> NTA 2013 Annual Report 165 (Most Serious Problem: *Exempt Organizations: The IRS Continues to Struggle with Revocation Processes and Erroneous Revocations of Exempt Status*).

than the number of first-time applications it usually receives in an entire year, four times the 2010 level, and more than triple the 2011 level.<sup>35</sup> Organizations consulting the "Where's My Exemption Application?" page on IRS.gov on February 14, 2014 learned "the average date of pending applications is April 2013,"<sup>36</sup> i.e., the IRS is just now getting around to applications submitted last April. Past EO executives exacerbated the problem by resisting TAS's authority to order expedited processing of applications and isolating EO from TAS.<sup>37</sup>

EO has adopted measures intended to reduce its backlog, especially for applications more than a year old.<sup>38</sup> As a result of these efforts, the timeframe for assignment of applications has been reduced from 18 months in December 2013 to ten months.<sup>39</sup> For example, the IRS suspended processing of new applications for a 60-day period beginning January 6, 2014, in order to devote more resources to working backlogged applications.<sup>40</sup> However, employees were instructed that "Applications requiring expedited treatment (including referrals from the Taxpayer Advocate Service where it has been determined the taxpayer is suffering or is about to suffer a significant hardship within the meaning of IRC § 7811) will continue to be processed under existing procedures."<sup>41</sup>

As a first step toward addressing the problems I identified in my Special Report, I met in Cincinnati on August 7, 2013 with managers and employees in the EO Determinations

<sup>35</sup> National Taxpayer Advocate 2013 Annual Report to Congress 165 (Most Serious Problem: *Exempt Organizations: The IRS Continues to Struggle with Revocation Processes and Erroneous Revocations of Exempt Status*).

<sup>36</sup> Where is My Exemption Application?, available at <http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Where's-My-Application>, with last update of Feb. 11, 2014 (informing taxpayers, as of Feb. 14, 2014, that it would take EO about 14 days to acknowledge receipt of the application, up to an additional 90 days to either approve the application or request additional information, and, if the application needed to be assigned to an agent for development, up to an additional 180 days to be assigned. The average date of pending applications is April 2013.).

<sup>37</sup> National Taxpayer Advocate Special Report, at 28.

<sup>38</sup> *The State of the IRS*, Hearing before the H. Comm. on Ways and Means, Subcomm. on Oversight, 113th Cong. 2nd Sess. (Feb. 5, 2014) (written testimony of John A. Koskinen, Commissioner, Internal Revenue Service, 9-10), available at <http://waysandmeans.house.gov/calendar/eventsingle.aspx?EventID=368226>. Additionally, on Jan. 2, 2014, the IRS published a revenue procedure that provides for streamlined procedures for reinstating the tax-exempt status of organizations whose status had been automatically revoked. See Rev. Proc. 2014-11, 2014-3 I.R.B.411.

<sup>39</sup> See NTA 2013 Annual Report 165 (Most Serious Problem: *Exempt Organizations: The IRS Continues to Struggle with Revocation Processes and Erroneous Revocations of Exempt Status*), noting that as of Nov. 14, 2013, organizations consulting the "Where is My Exemption Application?" page on IRS.gov were informed that applications requiring review by an EO specialist would take a year and a half just to be assigned.

<sup>40</sup> Memorandum from Acting Director, Exempt Organizations Rulings and Agreements, *Suspension of Initial Classification of Applications for 60 days* (Dec. 27, 2013).

<sup>41</sup> *Id.*

Unit.<sup>42</sup> By the end of August 2013, under instructions from newly-appointed EO leadership, EO employees routinely accepted TAS requests for expedited processing where TAS determined that the taxpayer was suffering or about to suffer significant hardship within the meaning of IRC § 7811, and no longer insisted on applying only EO expedite criteria.<sup>43</sup> In December of 2013, my staff and I developed training courses on the requirements for obtaining exempt status under IRC § 501(c)(3) and (c)(4), and on how EO processes applications for exempt status.<sup>44</sup> All TAS case advocacy employees will be required to complete the training by March 14.<sup>45</sup> I expect that with this training, our employees will be better able to assist taxpayers when the delays associated with their applications are causing significant hardship to the organizations or their beneficiaries.

The training instructs TAS employees how to advocate for taxpayers in light of EO's processes and procedures and will be supplemented with written guidance with case studies. Additionally, TAS and EO are collaborating to develop training for EO employees about TAS and our statutory advocacy function, which is expected to be available by this June. I expect this training to help EO employees understand TAS's role, statutory authority, and operating procedures, and to recognize when they should refer cases to TAS.

EO's new leadership team, upon taking office in June of 2013, immediately responded to overtures from TAS and signaled that it would depart from the previous practice of noncooperation described in my Special Report.<sup>46</sup> TAS and EO managers and executives now meet regularly to discuss general procedures as well as specific cases, and the Special Counsel to the National Taxpayer Advocate has begun monthly meetings with Chief Counsel Tax Exempt and Government Entities (TE/GE) executives to discuss EO and other TE/GE issues. Through the regular meetings with EO managers and executives, TAS is assisting EO to manage its inventory backlog and improve customer service. For example, organizations seeking exempt status sometimes approach EO through more than one channel. They may contact EO directly, they may contact TAS directly, they may contact their representative in Congress who in turn directs them to TAS, or they may adopt a combination of these

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<sup>42</sup> The visit was reported in TE/GE's internal newsletter, TE/GE Connect, *National Taxpayer Advocate Meets with Cincinnati Employees*, IRS intranet, <http://tege.web.irs.gov/my-news/2013/08/tas-ee-employees.asp> (last visited Feb. 14, 2014).

<sup>43</sup> Email from Acting Director, EO Rulings and Agreements, to front-line managers (Aug. 13, 2013).

<sup>44</sup> As described below, two videos were recorded on DVDs, designated as C01 and C02, and accompanying written training materials were prepared, designated with course numbers of 55250-102 (student guide) and 55250-103 (facilitator guide).

<sup>45</sup> See National Taxpayer Advocate Special Report, at 28-34 (describing my commitment to provide this training).

<sup>46</sup> Notes of meeting between the Acting Director of Exempt Organizations and TAS's Executive Director of Systemic Advocacy (June 4, 2013), on file with TAS; see National Taxpayer Advocate Special Report, at 28, for a description of EO's cultural difficulty with TAS.



approaches. Consequently, EO may create and assign more than one case for the same organization.

To help identify duplicate cases, TAS now reports weekly to EO on cases for which it has issued Operations Assistance Requests (OARs).<sup>47</sup> TAS also provided instructions to other IRS offices that receive inquiries from organizations seeking exempt status on how to recognize from researching IRS databases when an organization has already requested assistance from TAS.<sup>48</sup> EO is exploring several ways to improve customer service and TAS has assisted in building the business case for one of its initiatives.<sup>49</sup> We have offered EO our assistance in developing a system for tracking employee requests for guidance (the lack of which contributed to the problems TIGTA identified in its May 2013 report). In the first six months or so following publication of the TIGTA report, TE/GE sent TAS 75 items of proposed procedures or correspondence for review, compared to 52 for the same June to December period in 2012, an increase of over 40 percent.<sup>50</sup> We continue to assist thousands of organizations with exempt organization issues.

- For FY 2013, TAS had 3,258 case receipts with this issue, 58 percent of which were Congressional referrals. We closed 2,621 cases, with a relief rate of 83 percent.
- In FY 2014 to date, we have received 1,501 cases with exempt organization issues, 65 percent of which were Congressional referrals. We have closed 1,331 cases, with a relief rate of 84 percent.

My employees also continue to advocate for EO taxpayers through the Taxpayer Assistance Order (TAO), issuing 53 TAOs to EO from June of 2013 through February 13, 2014, five of which involved applications under IRC § 501(c)(4).<sup>51</sup> EO complied with 49 of the 53 TAOs, three are still open, and one was rescinded.

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<sup>47</sup> TAS uses an Operations Assistance Request (OAR) to request action on a taxpayer account by the responsible IRS function.

<sup>48</sup> Email from TAS Director of Technical Analysis & Guidance to cross-functional TE/GE Correspondence Assistance team that includes TAS (Nov. 6, 2013), on file with TAS.

<sup>49</sup> EO, while working with the IRS Office of Online Services to revise the "Where is My Exemption Application?" webpage, solicited data about the volume of inquiries to TAS about determination status and the resources this consumes to help bolster its position that a better online tool is needed. TAS provided submissions on the TAS Systemic Advocacy Management System (SAMS) that related to this issue.

<sup>50</sup> From May 31, 2012 to Dec. 10, 2012, TAS received 52 Internal Revenue Manual (IRM) chapters from TE/GE for review. From May 31, 2013 to Dec. 10, 2013, TAS received 57 IRM chapters from TE/GE for review, as well as 13 interim guidance memoranda and five draft letters or notices to taxpayers for a total of 75 items. TAS IMD SPOC. Seventy-five is an increase of 44 percent over 52.

<sup>51</sup> Under IRC § 7811, the National Taxpayer Advocate (or her delegate) can issue a Taxpayer Assistance Order (TAO) to order the IRS to take certain actions, cease certain actions, or refrain from taking certain actions (e.g., to release a levy). A TAO may also be issued to order the IRS to expedite consideration of a taxpayer's case, reconsider its determination in a case, or review the case at a higher level. Treas.

#### IV. Identity Theft and Refund Fraud

As I have written in nearly every Annual Report I have delivered to Congress since 2004, tax-related identity theft is a serious problem – for its victims, for the IRS and, when Treasury funds are improperly paid to the perpetrators, for all taxpayers.<sup>52</sup> In general, tax-related identity theft occurs when an individual intentionally uses the Social Security number of another person to file a false tax return to obtain an unauthorized refund.<sup>53</sup>

Within my organization, the Taxpayer Advocate Service (TAS), identity theft receipts increased sharply over the past decade, accounting for approximately one out of four cases in our inventory in recent years.

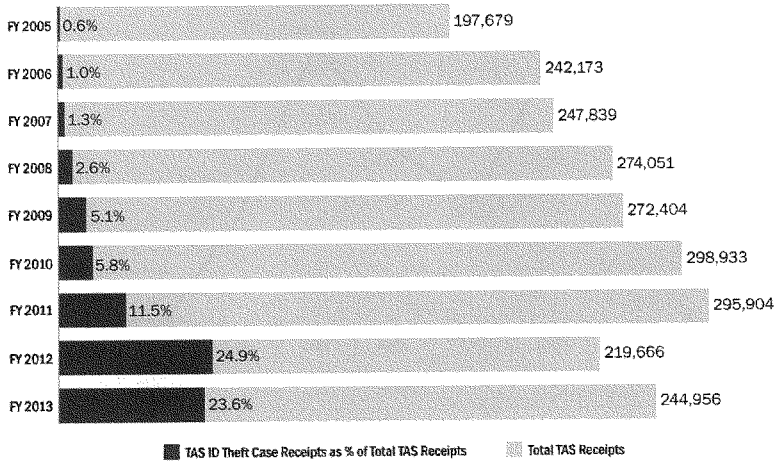
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Reg. § 301.7811-1(c). Once a TAO is issued, the IRS can comply with the action ordered or appeal the issue for resolution at a higher level. IRM 13.1.20.5(2) (Dec. 15, 2007).

<sup>52</sup> See National Taxpayer Advocate 2013 Annual Report to Congress 75-83 (Most Serious Problem: *The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers*); National Taxpayer Advocate 2012 Annual Report to Congress 42-67 (Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft*); National Taxpayer Advocate 2011 Annual Report to Congress 48-73 (Most Serious Problem: *Tax-Related Identity Theft Continues to Impose Significant Burdens on Taxpayers and the IRS*); National Taxpayer Advocate 2009 Annual Report to Congress 307-317 (Status Update: *IRS's Identity Theft Procedures Require Fine-Tuning*); National Taxpayer Advocate 2008 Annual Report to Congress 79-94 (Most Serious Problem: *IRS Process Improvements to Assist Victims of Identity Theft*); National Taxpayer Advocate 2007 Annual Report to Congress 96-115 (Most Serious Problem: *Identity Theft Procedures*); National Taxpayer Advocate 2005 Annual Report to Congress 180-191 (Most Serious Problem: *Identity Theft*); National Taxpayer Advocate 2004 Annual Report to Congress 133-136 (Most Serious Problem: *Inconsistence Campus Procedures*).

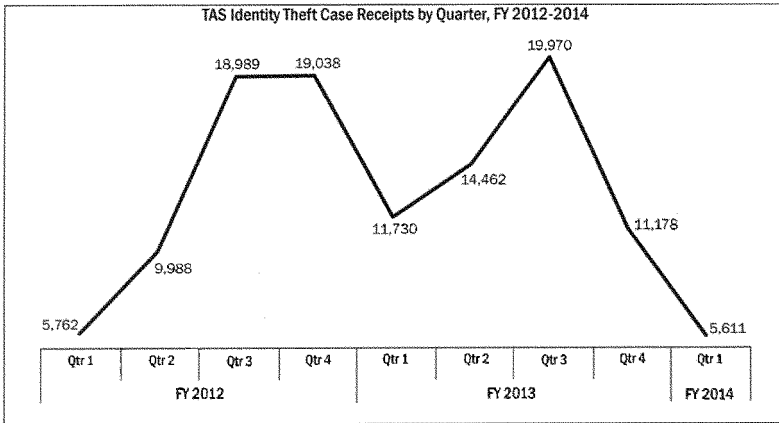
<sup>53</sup> The IRS refers to this type of tax-related identity theft as "refund-related" identity theft. In "employment-related" identity theft, an individual files a tax return using his or her own taxpayer identifying number (usually an Individual Taxpayer Identification Number or ITIN), but uses someone else's SSN to obtain employment. Consequently, the wages are reported to the IRS under the SSN of the victim, potentially prompting the IRS to pursue the victim for additional tax on the apparent income. See IRM 10.5.3.2(4), *Identity Protection Program Service-wide Identity Theft Guidance* (Feb. 27, 2013). Unlike in 1993, when I first represented a client in an identity theft case, the IRS now has procedures in place to minimize the tax administration impact to the victim in these employment-related identity theft situations. Accordingly, I will focus on refund-related identity theft in this testimony.

**Figure 2: Taxpayer Advocate Service ID Theft Cases<sup>54</sup>**  
 TAS Identity Theft Case Receipts, FY 2005-FY 2013



Identity theft receipts in TAS have finally started to decline in the past two quarters (although it is too early to tell whether this decline represents an actual decline in identity theft cases or is simply a result of cyclical variance). I believe this is because, in part, the IRS has done a better job of developing automated filters that flag suspicious returns and delay the payout of refunds while the refund claims are scrutinized. The IRS has also improved some of its victim assistance procedures and has been able to reduce its backlog of identity theft cases.

<sup>54</sup> Case receipt data obtained from the Taxpayer Advocate Management Information System (TAMIS) on February 13, 2014.

**Figure 3: TAS ID Theft Cases by Quarter<sup>55</sup>**

When we first started writing about tax-related identity theft in 2004, the IRS had no procedures for its employees to follow when a taxpayer claimed to be a victim of ID theft. Since then, the IRS has established a program office to develop victim assistance procedures and has adopted many of the recommendations we have made over the years.

<sup>55</sup> Case receipt data obtained from TAMIS on February 13, 2014.

**Figure 4: TAS Recommendations Adopted by IRS to Assist ID Theft Victims**

NISP Year	Rec. #	TAS Recommendation	Year First Recommended	Year IRS Adopted
2004	9-A2	Revise the IRM to provide that scrambled procedures be used only after phone contact is attempted with the SSN users and only in those cases where available information clearly supports use of the SSN by both taxpayers.	2004	2009
2004	9-A3	Standardize procedures for information required from taxpayers.	2004	2009
2005	9-1	Conduct appropriate training for employees who determine whether to send cases to the SSA.	2005	2009
2005	9-2	Integrate awareness of identity theft into various training modules throughout the operating divisions and functions, so all employees are sensitive to this issue and can refer taxpayers to the appropriate IRS function.	2005	2011
2005	9-3	Use an electronic indicator on its master files to mark the accounts of taxpayers who have verified that they have been victims of identity theft.	2005	2008
2007	6-2	Develop a form that taxpayers can file when they believe they have been victims of identity theft. The instructions on the form should explain which steps the IRS will take and which steps the taxpayer should take (e.g., obtaining an FTC affidavit) to restore the integrity of the taxpayer's account.	2007	2009
2007	6-7	Create a prefix for IRS numbers (IRSNs) or some other system so that it does not deny tax benefits to the rightful owner of the Social Security number (SSN). While assignment of IRSNs may be the only way to isolate the fraud taking place under an SSN, it is inequitable to assign the IRSN to identity theft victims and then deny tax benefits that depend on the SSN.	2007	2012

Yet, the IRS still has much room for improvement in how it addresses identity theft. For starters, it must recognize that the consequences for victims can be significant. Being victimized by an identity thief is a traumatic life event; when someone steals and uses your identity, it is an invasion of your person. On top of that, the victim must spend time and energy having to prove his or her identity to the IRS and must endure months of aggravation and frustration before receiving his or her tax refund. The IRS's current approach in many ways treats the victim as someone experiencing a minor inconvenience, instead of a frightening personal disaster.

In acknowledging that identity theft is a traumatic life event, the IRS should set up a centralized identity theft unit similar to the innocent spouse unit that assists taxpayers who are seeking relief from joint and several liability. It is important to have a centralized unit with specially trained employees who can remain on the case as a single point of contact with the victim from the beginning to full case resolution. Otherwise, the IRS would be guilty of contributing to the problem and perpetuating the trauma to the victim. When I visited the IRS Identity Protection Specialized Unit (IPSU) unit last summer, I met with front-line employees, many of whom expressed frustration about not truly "owning" a case and having to wait for other functions to take actions on these cases that the IPSU could have easily completed.

In my latest report to Congress, I recommended that the IRS designate the IPSU as the centralized function that assigns a single employee to work with ID theft victims until all related issues are resolved. In my meetings with the new IRS leadership, they have

expressed willingness to revisit whether the current decentralized approach is the right one. I have offered to collaborate with the Wage and Investment division to test the effectiveness of creating a meaningful single point of contact for victims of identity theft with cases that require the involvement of multiple IRS functions (for example, where the taxpayer is not only trying to get a current year's return refund but also seeking abatement of an assessment attributable to a prior year's identity theft return).

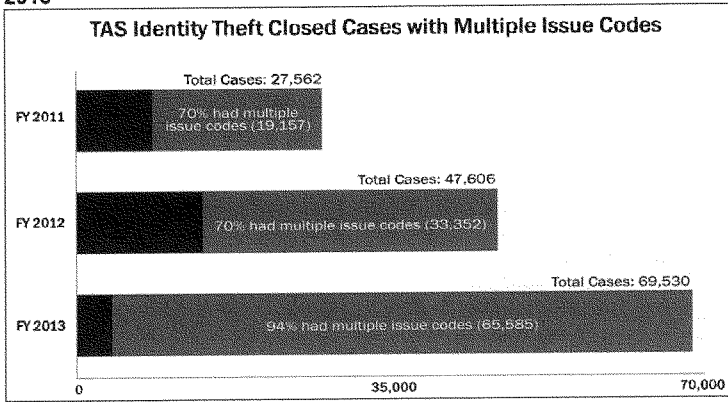
The IRS takes much too long to resolve ID theft cases and issue refunds to the legitimate taxpayers, particularly where the case moves back and forth among IRS functions. A 2013 TIGTA report found the IRS took an average of 312 days to work the 100 ID theft cases in their sample.<sup>56</sup> This included 277 days of inactivity. In other words, though the cases lingered in various IRS units for approximately ten months, the average case in TIGTA's sample was resolved with just 35 days of direct contact.

The IRS's current approach of using more than 20 specialized units to handle discrete aspects of an identity theft victim's case is simply not working. As far as the victims are concerned, there should be *one* IRS employee who interacts with the taxpayer. That one employee should maintain control of the taxpayer's case, including all peripheral issues stemming from the identity theft. Because identity theft cases are often very complex, and can involve multiple issues spanning multiple years, too many victims fall between the cracks of the IRS bureaucracy.

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<sup>56</sup> See TIGTA, Ref. No. 2013-40-129, *Case Processing Delays and Tax Account Errors Increased Hardship for Victims of Identity Theft* (Sept. 26, 2013).

**Figure 5: Percent of TAS ID Theft Cases with Multiple Issue Codes, FY 2011 - 2013<sup>57</sup>**



The Taxpayer Advocate Service's experience with working identity theft cases demonstrates the soundness of our recommendation that the IRS should assign one employee to work with the victim from the beginning, and oversee the case when it requires coordination among different units. Instead of taking 312 days to work an identity theft case, TAS case advocates resolve them in 87 days.<sup>58</sup> And even though identity theft cases are complex (with over 94 percent of our identity theft cases closed in FY 2013 involving more than one issue code), TAS case advocates have achieved a relief rate of 87 percent.<sup>59</sup> Furthermore, an overwhelming 94 percent of identity theft victims who came to TAS in fiscal year 2013 have expressed satisfaction with our assistance.<sup>60</sup>

The IRS also needs to do a better job of tracking identity theft case data. The IRS cannot even provide a reliable figure for the number of identity theft victims it has assisted, partly because the various specialized units use different systems to track cases. Moreover, while some IRS functions track the length of time a case is in their

<sup>57</sup> The IRS does not track the number of issues in a given identity theft case because, unlike TAS, it treats each module (year/tax/issue) as a different case. Accordingly, we can provide TAS data only. This chart is meant to illustrate that the vast majority of TAS identity theft cases involve multiple issue codes. The increase in the percentage of cases with multiple issue codes from FY 2011 to FY 2013 may be due to better coding by TAS case advocates to record secondary issue codes; it does not necessarily mean that TAS identity theft cases have become more complex in recent years.

<sup>58</sup> Analysis conducted by TAS Technical Analysis and Guidance of data obtained from TAMIS (Oct. 1, 2013).

<sup>59</sup> *Id.*

<sup>60</sup> Analysis conducted by TAS Business Assessment of customer satisfaction scores reported for FY 2013 (through June 2013); data obtained from TAMIS (Oct. 1, 2013).

inventory, the IRS still cannot provide an overall cycle time from the taxpayer's perspective. For example, specialized units generally measure cycle time from the date that particular unit received the case; it does not reflect the time elapsed since the taxpayer attempted to file the initial return, or all of the prior interactions the victim may have had with the IRS. In my 2013 Annual Report to Congress, I recommended that the IRS develop a method of tracking cycle time *from the perspective of the victim*.

## V. Affordable Care Act

As part of the Affordable Care Act (ACA), the IRS is implementing complicated health care tax provisions that require new technology and significant rule-making.<sup>61</sup> These provisions would present a serious administrative challenge to any agency, but for one such as the IRS, with its annual and continuing tax administration duties, the added work is daunting. To date, I believe the IRS has acquitted itself well in meeting its initial responsibilities under the ACA. Specifically, the IRS has done an impressive job of updating information technology (IT) systems, issuing guidance, and attempting to collaborate with other federal agencies. The IRS's actions with regard to ACA implementation demonstrate what the IRS can do when it has sufficient lead time to plan and implement a complex social benefit delivered through the tax system.

While the opening of the Health Insurance Marketplaces<sup>62</sup> on October 1, 2013, was riddled with problems, the one aspect that went better than anticipated was the role of the IRS in providing information to the Marketplace on household income and family size. Originally, the IRS agreed that queries from the Marketplace would have an average response time of less than five seconds. However the IRS has been providing an average response time of less than one second.<sup>63</sup> The IRS is to be commended on its ability to surpass expectations thus far.

In order to ensure that ACA design and implementation treat taxpayers – both individuals and businesses – appropriately and fairly, the Taxpayer Advocate Service has been actively involved with the IRS roll-out of the Affordable Care Act tax provisions. I personally sit on the ACA Executive Steering Committee and have staff throughout TAS on the ACA Joint Implementation Teams to ensure the provisions are implemented in a fair and equitable manner and that taxpayer rights are protected.<sup>64</sup>

<sup>61</sup> See Patient Protection & Affordable Care Act of 2009, Pub. L. No. 111-148, 124 Stat. 119 (Mar. 23, 2010), as amended by the Health Care & Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (Mar. 30, 2010).

<sup>62</sup> <https://www.healthcare.gov/marketplace/individual>.

<sup>63</sup> This is due, in part, to a lower than anticipated volume of inquiries. Data provided verbally at ACA Executive Steering Committee on Nov. 13, 2013.

<sup>64</sup> The Joint Implementation Teams TAS is represented on are: Customer Service Operations, Tax Return Processing, Information Return Receipt and Processing, ACA Notices and Correspondence, Compliance – Individuals, Compliance – Business, and Collection.



### *ACA Taxpayer Service and Training Raise Concerns*

The true test for the IRS will be in 2015, when taxpayers begin filing their 2014 tax returns. This will be the first year taxpayers will have to provide information regarding their health insurance coverage (or pay a penalty excise tax<sup>65</sup>) and many taxpayers will have to reconcile the Premium Tax Credit amounts they are currently receiving with the amounts to which they are entitled, based on their actual (as opposed to projected) 2014 income.<sup>66</sup> Although the IRS has been successful in many aspects of ACA implementation, it is lagging in one of the most critical areas – addressing taxpayer questions and adequately training employees on the new provisions. The IRS has adopted a “Web First” assistance and education strategy that directs taxpayers to various web pages for additional information.

While other agencies have telephone or web chat options, the IRS’s web-first strategy acts more as a “web-only” strategy that limits taxpayers’ access to in-person assistance with *tax-related* health care questions.<sup>67</sup> The IRS has specifically advised its assistants “the best service to the customer is to provide the web URLs. This is known as the ‘Web First’ strategy.”<sup>68</sup> In comparison, Healthcare.gov has telephone assistants trained to answer questions, as well as a live web chat option.<sup>69</sup>

<sup>65</sup> IRC § 5000A is in Subtitle D, *Misc. Excise Taxes*, of Title 26, U.S.C. At the same time, this excise tax is what ACA “describes as a ‘penalty.’” *Nat’l Fed’n of Ind. Business v. Sebelius*, 132 S Ct. 2566, 2580 (2012). There are exceptions for individuals who: have religious objections documented in a certificate issued by an Exchange to members of a recognized sect who adhere to established religious tenets; are not lawfully present in the U.S.; are incarcerated for at least one day of the applicable month in a jail, prison, or similar penal institution or correctional facility after the disposition of charges; have income below the tax filing threshold; lack coverage for fewer than three months; cannot afford coverage where the required contribution exceeds eight percent of household income for 2014; are members of federally recognized Indian tribes; or have suffered hardship as certified by an Exchange with respect to the capability to obtain minimum essential coverage (including, among others, patients of the federal Indian Health Service not enrolled in a recognized tribe). On affordability, “if an employee with a family is offered self-only coverage costing five percent of income and family coverage costing ten percent of income, the employee is not eligible for the tax credit in the Exchange because self-only coverage costs less than 9.5 percent of household income. The employee is not exempt from the individual responsibility penalty on the grounds of an affordability exemption because the self-only plan costs less than eight percent of income.” *Jt. Comm. on Tax’n, Technical Explanation of the Revenue Provisions of the “Reconciliation Act of 2010,” as Amended, in Combination with the “Patient Protection and Affordable Care Act”*, JCX-18-10, p. 33, n. 70 (Mar. 21, 2010).

<sup>66</sup> The Premium Tax Credit is a refundable, advanceable tax credit available to help low and middle income taxpayer purchase health insurance through a Marketplace. IRC § 36B.

<sup>67</sup> See Health Insurance Market Place, *Help-Center*, <https://www.healthcare.gov/help-center/> (last visited Aug. 12, 2013).

<sup>68</sup> IRS, *Affordable Care Act Web First Strategy: Addressing Health Care Law Inquiries*, [http://win.web.irs.gov/field/fadocs/ACA\\_Web\\_First\\_Strat.pdf](http://win.web.irs.gov/field/fadocs/ACA_Web_First_Strat.pdf) (last visited Apr. 30, 2013).

<sup>69</sup> See Health Insurance Market Place, *Help-Center*, <https://www.healthcare.gov/help-center/> (last visited Aug. 12, 2013).

Websites alone may not meet the needs of taxpayers dealing with complicated new provisions for the first time.<sup>70</sup> Moreover, those who are eligible for the Premium Tax Credit may not have the necessary language or computer literacy skills,<sup>71</sup> and those who lack Internet access still need IRS assistance through other channels. Obtaining health care is an inherently complicated and personal decision that can have a major impact on a taxpayer's life and finances. If the IRS cannot answer tax-related questions, taxpayers may unknowingly make health care choices that carry significant tax implications.

*The IRS Is Not Adequately Training Assistors to Respond to Taxpayer Questions on Health Care Issues.*

As discussed above, due to resource constraints the IRS already cannot answer millions of telephone calls or respond timely to volumes correspondence from taxpayers.<sup>72</sup> The new work caused by the ACA will compound this backlog. The IRS estimates it needs almost 2,000 new employees to handle the numerous additional calls and letters that may arrive once applicable provisions take effect.<sup>73</sup> Absent additional employees dedicated to the ACA, the IRS must ensure that the employees it does have – particularly in taxpayer-facing roles – are properly trained to respond to taxpayer inquiries.

The IRS has provided some general ACA information to employees but has not yet engaged in substantive training. The IRS says it is developing training for 2014, but TAS has yet to see or review its training plan. In contrast, TAS has been providing training to its employees on the Affordable Care Act since 2010, to give them time to digest and develop a basic understanding of the new provisions. TAS plans to continue this training through 2014, adding more in-depth sessions and specific case studies. It

<sup>70</sup> Existing IRS functions, such as Stakeholder Partnership, Education & Communication (SPEC), Stakeholder Liaison, and Taxpayer Assistance Centers may receive questions and even visits from taxpayers who want to know about the ACA. See *SPEC Outreach Summary* (Filing Season Jan.-Apr. 2013) (containing 3-pg. ACA Overview); IRS Pub. 5093, *Healthcare Law Online Resources* (1 pg. listing a half-dozen URLs for individuals & employers).

<sup>71</sup> Adults "living in households earning at least \$50,000 per year are more likely to have home broadband than those at lower income levels." Pew Res. Ctr., *Home Broadband 2013*, available at <http://pewinternet.org/Reports/2013/Broadband.aspx> (last visited Sept. 17, 2013). As of 2011, only "75.6 percent of households reported having a computer," which means almost a quarter of the nation's households may be unable to get the information they need from the IRS's web strategy. U.S. Census Bureau, *Computer and Internet Use in the United States*, P20-569 (May 2013) 1. See also National Taxpayer Advocate 2011 Annual Report to Congress 273, 279 (Introduction to Diversity Issues: *The IRS Should Do More to Accommodate Changing Taxpayer Demographics*) ("low income, less educated, minority, elderly, disabled, or rural populations are less likely than others to use the Internet").

<sup>72</sup> See NTA 2013 Annual Report 20 (*Most Serious Problem: IRS Budget Cuts Diminish Taxpayer Service*); National Taxpayer Advocate 2012 Annual Report to Congress 34 (*Most Serious Problem: The IRS Is Significantly Underfunded to Serve Taxpayers and Collect Tax*); IRS Joint Operation Center (JOC) Snapshot Report for fiscal year 2013 (Sept. 30, 2013) and JOC Accounts Management Inventory Reports for fiscal year 2013 (Oct. 6, 2012 – Sept. 28, 2013).

<sup>73</sup> See IRS FY 2014 President's Budget, Table 4.9 at 169.

is my understanding that one of the ACA Implementation Teams is reviewing the ACA training TAS offered this year to see if it meets the needs of the ACA overview all IRS employees should receive. I encourage the IRS to use TAS's training and ensure that all IRS employees receive basic training on the new health care provisions.

*IRS Outreach Does Not Alert Taxpayers to the Issues Surrounding a Change in Circumstances.*

The IRS has made strides in its ACA outreach efforts. It has issued several user-friendly publications for taxpayers regarding the Premium Tax Credit, and we understand it plans similar publications for the employer provisions and Shared Responsibility Payment.<sup>74</sup> Additionally, the IRS has made efforts to improve the ACA pages on IRS.gov, including a new page specifically on the Premium Tax Credit<sup>75</sup> as well as updated Q&As and legal guidance.<sup>76</sup> The IRS also plans to create a page on the 5000A Individual Shared Responsibility Payment. TAS will continue to work with the IRS on its outreach efforts.

However, we remain concerned that the IRS is not being proactive and educating taxpayers as early as possible on a critical issue: the importance of updating their information throughout the year with the Exchange if they are receiving a credit.<sup>77</sup> To avoid receiving an excess credit, taxpayers must update their information with the marketplace if their income or other relevant circumstances change.<sup>78</sup> This is also

<sup>74</sup> Thus far, the IRS has issued several electronic publications, including Pub. 5093, *Health Care Law Online Resources* (July 2013), Pub. 5120, *Facts About the Premium Tax Credit* (flyer) (Sept. 2013), and Pub. 5121, *Facts About the Premium Tax Credit* (brochure) (Dec. 2013). We understand that Spanish versions of the publications are in progress.

<sup>75</sup> The ACA homepage is located at <http://www.irs.gov/aca>. The Premium Tax Credit page is located at <http://www.irs.gov/uac/The-Premium-Tax-Credit>.

<sup>76</sup> <http://www.irs.gov/uac/Newsroom/Affordable-Care-Act-Tax-Provisions-Questions-and-Answers>.

<sup>77</sup> To apply for a premium assistance credit, an individual goes to an Exchange, which will attempt to verify household income with the IRS. In general, applicable taxpayers seeking health insurance and a premium tax credit through an Exchange will supply names, Social Security numbers, and income data for themselves and their dependents to the Exchange. See ACA § 1411(b), 124 Stat. 119, 224 (2010). The Exchange can verify data with HHS, which has authority under the ACA to obtain IRS data, and then disclose any inconsistency to the Exchange. See IRC § 6103(l)(21). If IRS information is inaccurate or outdated, the individual may need to present updated documentation or other evidence to HHS to establish eligibility for a premium tax credit. If a taxpayer's household status at year's end is other than anticipated – due either to a change in income or family size – the premium tax credit may be more or less than the amount advanced. Consequently, the IRS may recover the excess as a tax (below a ceiling for low income taxpayers), or owe the taxpayer a refund. Section “36B(f)(2)(B) places a graduated set of caps on the additional tax liability for taxpayers with household income under 400 percent of the F[ederal] P[overty] Level]. The repayment limitation amounts range from \$600 to \$2,500 (one-half that amount for single taxpayers) depending on FPL, and are adjusted to reflect changes in the cost of living beginning in 2015.” 76 Fed. Reg. 50931, 50933-934 (Aug. 17, 2011).

<sup>78</sup> Income may change after submission of an application, which reflects the amount on the last tax return, i.e., the one filed in the current year relating to the year that just ended. Thus, a couple of years' worth of life changes may transpire by the time of reconciliation between the advance and ultimate credit amounts.

important for taxpayers who may be eligible for a larger credit due to a reduction in pay or an increase in family size (such as having or adopting a child). Educating taxpayers early and repeatedly about this requirement will help prevent them from owing money to the IRS (or reducing their refunds) or receiving an additional credit amount at the end of the year.

Healthcare.gov now has a "Report Life Change" button that allows individuals to modify their health insurance plans (once they are enrolled) if they have experienced a change such as family size, moving, etc.<sup>79</sup> Assuming this option will also allow for a recalculation of the Premium Tax Credit based on these changes, the IRS can easily tie its messages about changing circumstances into this new option.

TAS worked with the IRS to prominently place language in the 2013 Form 1040, *U.S. Individual Income Tax Return*, instructions to alert taxpayers of the importance of updating their information with the marketplaces. However, the IRS still needs to be more proactive. While almost 80 percent of individual returns are refund returns and thus may offset some or all of the reconciliation amount, the IRS should be doing all it can to ensure that as few taxpayers as possible have excessive advanced premium tax credit payments and instead receive the correct amount throughout the year.<sup>80</sup> In addition to preventing taxpayers from owing money, this approach will reduce future costs to the IRS for collection activities.<sup>81</sup>

I have additional concerns that other taxpayers will have their returns delayed because they claim a larger Premium Tax Credit than what they received during the year due to a change in circumstances. If the IRS flags these returns as potentially fraudulent, it may hold up legitimate refunds. TAS has seen these issues previously, especially when large dollar amounts are at stake.<sup>82</sup>

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By the same token, certain changed circumstances, such as the birth of a child or a reduction in pay, may increase the credit.

<sup>79</sup> Amy Goldstein, *Administration will allow people to switch health-care plan to a limited degree*, Washington Post (Feb. 7, 2014) available at [http://www.washingtonpost.com/national/health-science/administration-will-allow-people-to-switch-obamacare-plans-to-a-limited-degree/2014/02/07/56c8bfd2-9015-11e3-b227-12a45d109e03\\_story.html](http://www.washingtonpost.com/national/health-science/administration-will-allow-people-to-switch-obamacare-plans-to-a-limited-degree/2014/02/07/56c8bfd2-9015-11e3-b227-12a45d109e03_story.html) (last visited Feb. 18, 2014).

<sup>80</sup> IRS Compliance Data Warehouse, Individual Returns Transaction File Tax Year 2012 (Feb. 2014).

<sup>81</sup> TAS looks forward to working with RAS to try to identify the areas and populations of taxpayers most likely to have experienced a change in circumstances. This information can be used by the IRS's SPEC organization, TAS Local Taxpayer Advocates (LTAs), Low Income Taxpayer Clinics (LITCs), and other stakeholders to conduct outreach to these specific populations.

<sup>82</sup> National Taxpayer Advocate 2012 Annual Report to Congress 111-133 (Most Serious Problem: *The IRS's Compliance Strategy for the Expanded Adoption Credit Has Significantly and Unnecessarily Harmed Vulnerable Taxpayers, Has Increased Costs for the IRS, and Does Not Bode Well for Future Credit Administration*); National Taxpayer Advocate Fiscal Year 2012 Objectives Report to Congress 28-32; National Taxpayer Advocate 2011 Annual Report to Congress 687-689 (Case Advocacy: *Policymakers Can Learn from the Implementation of the FTHBC*); National Taxpayer Advocate Fiscal Year 2011 Objectives Report to Congress 3, 37-43; National Taxpayer Advocate 2010 Annual Report to Congress 15 (Most Serious Problem: *The IRS Mission Statement Does Not Reflect the Agency's Increasing Responsibilities for Administering Social Benefits Programs*) (Case Advocacy: *TAS Assists the*

While there will always be persons trying to game the tax system, I believe the risk of fraud with respect to the PTC is much less than with many other refundable credits. With respect to the Advanced Premium Tax Credit, the credit will be paid to established insurance companies when a policy is actually in place. When a taxpayer claims the PTC on his or her income tax return, it is a *reimbursement* of amounts already paid; the taxpayer will have to provide proof of a qualified health insurance plan, which the IRS will be able to verify through third-party information reporting. This design minimizes the opportunities for fraud.

TAS is in the final stages of developing an estimator for the Premium Tax Credit that will help taxpayers and practitioners understand how changes in circumstances will impact their credit amounts. TAS hopes to have this tool online and available to the public in the next few months. We have had success with a similar estimator for the Small Business Health Care Tax Credit (SBHCTC), which we launched on the TAS Tax Toolkit in November 2012.<sup>83</sup> The homepage for the estimator received 5,000 page views for October 2013 and over 13,000 page views for October – December 2013.<sup>84</sup>

#### *Delays in Information Matching Show Need for Real-Time Tax System*

Last year, the Treasury Department delayed the requirement for certain employers with 100 or more employees to provide coverage to their employees.<sup>85</sup> Due to the delay in implementation, employers will not have to provide information reporting to the IRS regarding the employees they cover.<sup>86</sup> This information reporting will help identify which taxpayers have coverage and which do not (and therefore have to pay a penalty). We do not yet know how the IRS plans to address this lack of information during the 2015 filing season. TAS members on the relevant Joint Implementation Team have been told it will be discussed later.

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*IRS with the Administration of the First-Time Homebuyer Credit*; National Taxpayer Advocate 2009 Annual Report to Congress 506-509; *Hearing on Complexity and the Tax Gap: Making Tax Compliance Easier and Collecting What's Due*, Hearing Before the S. Comm. on Finance, 112th Cong. (statement of Nina E. Olson, National Taxpayer Advocate) (June 28, 2011); *Filing Season Update: Current IRS Issues*; Hearing Before the S. Comm. on Finance, 111th Cong. (2010) (statement of Nina E. Olson, National Taxpayer Advocate) (Apr. 15, 2010); *The National Taxpayer Advocate's 2009 Report on the Most Serious Problems Encountered by Taxpayers*; Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means, 111th Cong. (2010) (statement of Nina E. Olson, National Taxpayer Advocate) (Mar. 16, 2010).

<sup>83</sup> <http://www.taxpayeradvocate.irs.gov/Businesses/Small-Business-Health-Care-Tax-Credit-Estimator> (last visited Feb. 19, 2014). According to Weber Shandwick, which tracks statistics for the estimator, the SBHCTC estimator has received over 23,500 page views since its launch in 2012.

<sup>84</sup> Taxpayer Advocate Service, FY 2014 1<sup>st</sup> Quarter Business Performance Review.

<sup>85</sup> Continuing to Implement the ACA in a Careful, Thoughtful Manner, Treasury Notes, (July 2, 2013), available at <http://www.treasury.gov/connect/blog/Pages/Continuing-to-Implement-the-ACA-in-a-Careful-Thoughtful-Manner.aspx> (last visited Feb. 13, 2014). The requirement was further delayed until 2016 for employers with between 50 to 99 employees. Shared Responsibility for Employers Regarding Health Coverage, 79 Fed. Reg. 8543 (Feb. 12, 2014).

<sup>86</sup> Transition Relief for 2014 Under §§ 6055 (§ 6055 Information Reporting), 6056 (§ 6056 Information Reporting) and 4980H (Employer Shared Responsibility Provisions), Notice 2013-45.

Without this information, the IRS's job is increasingly difficult. This further strengthens my position on the need for a real-time tax system, discussed below.

## **VI. Accelerated Receipt and Use of Third-Party Information Reports**

*Accelerated Third-Party Information Report Processing and Upfront Document Matching Will Protect Revenue, Reduce Fraud, and Improve Taxpayer Service.*

Whether in the context of Premium Tax Credit reconciliation, eligibility for the Earned Income Tax Credit, or returns filed by identity thieves, the IRS faces pressure to satisfy two competing demands: protect the public fisc from erroneous refund claims and meet taxpayer expectations by issuing refunds quickly. Although the IRS has instituted many business rules and filters to identify questionable refunds, it generally matches third-party information reports with tax return data long after it has released any associated income tax refunds.<sup>87</sup>

In 2009, I recommended that Congress establish a timeframe for the IRS to develop a strategy and timeline for accelerating third-party information report processing and providing taxpayers with electronic access to such data.<sup>88</sup> Most recently, a study in my 2013 Annual Report provides a strategic framework and preliminary recommendations to better structure the filing season to reduce fraud and protect the interests of both the government and taxpayers.<sup>89</sup> This is a key component of 21<sup>st</sup> century tax administration.

The government benefits from the revenue protection aspect of accelerated third-party information report processing and upfront document matching. Third-party information reporting is a crucial element in maximizing tax compliance.<sup>90</sup> By enabling the IRS to match third-party data to tax return information before issuing refunds, the IRS could identify and resolve inaccurate income reporting soon after the return is filed and

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<sup>87</sup> For a more detailed discussion of the IRS's processes to review refund returns, see Nina E. Olson, *More Than a 'Mere' Preparer: Loving and Return Preparation*, 2013 TNT 92-131, Tax Notes Tax Analysts Tax Notes Today (May 13, 2013).

<sup>88</sup> National Taxpayer Advocate 2009 Annual Report to Congress 338-345; National Taxpayer Advocate 2011 Annual Report to Congress 284-295; National Taxpayer Advocate 2012 Annual Report to Congress 180-191.

<sup>89</sup> NTA 2013 Annual Report vol. 2, 67-96.

<sup>90</sup> Tax gap data show the importance of information reporting compliance, and how third-party reporting is essential to encourage voluntary compliance; specifically, when taxpayers have a choice about reporting their income, tax compliance rates are remarkably low. For example, workers who are classified as employees have little opportunity to underreport their earned income because it is subject to both information reporting on Forms W-2 and tax withholding. In fact, IRS data show that taxpayers report about 99 percent of their wages and salaries. IRS, *Tax Gap for Tax Year 2006 Overview*, Chart 1 (Jan. 6, 2012).

prevent the release of erroneous refunds. This system would deter tax fraud and identity theft by stopping the refund associated with a mismatch.

In addition, accelerated information report processing and upfront matching would substantially improve taxpayer service and reduce taxpayer burden by:

- Providing taxpayers with direct electronic access to the third-party information report data to assist in tax preparation and reduce inadvertent errors;<sup>91</sup>
- Improving taxpayers' ability to answer questions about an underlying economic transaction if the IRS identifies the mismatch within months rather than a year or more after the fact;
- Avoiding IRS collection actions long after taxpayers have spent the refunds;
- Avoiding the long-term accrual of penalties and interest on unintentionally omitted or under-reported items; and
- Reducing vulnerability to identity-theft related refund fraud.<sup>92</sup>

While the IRS has acknowledged the benefits of accelerated third-party information report processing and upfront matching, it has not made any recent progress in developing a long-term plan for such a system.<sup>93</sup> The IRS's lack of progress only delays the significant benefits we outlined throughout the study. Thus, we reiterated our 2009 Legislative Recommendation that Congress require the IRS and Treasury, in consultation with the Taxpayer Advocate Service, to prepare a plan and timeline to achieve an accelerated third-party report processing system.

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<sup>91</sup> Taxpayers will not realize the full benefits of accelerated third-party information reporting unless the IRS provides taxpayers and their preparers with the ability to access and download their third party data from an online account. To address inadvertent omissions, the IRS should provide access to real-time transcripts of third-party data to aid in return preparation. Taxpayers and preparers could refer to the transcripts to ensure they do not accidentally omit income. One step above the transcript would be to provide a platform from which taxpayers and preparers could download third-party data submitted to the IRS or the Social Security Administration directly into a commercial tax software package or even an improved version of the IRS's Free File Fillable Forms (FFFF). This second option would eliminate transcription errors and provide a one-stop-service to taxpayers who would not need to download the data separately from each third party. In addition, the government would enjoy the benefits experienced by other tax administrations through pre-filled returns, but would still encourage competition in the tax software industry. For more information on the benefits of electronic access to third-party data and the experience of international tax administrations, see National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 67-96.

<sup>92</sup> William Hoffman, *IRS Oversight Board Brainstorms Real-Time Tax System, ID Theft Initiatives*, Tax Notes Today (May 2, 2013); IRS, PowerPoint, *Real Time Tax System Initiative, Public Meeting 1* (Dec. 8, 2011), available at [http://www.irs.gov/file\\_source/pub/irs-utl/rtrts\\_deck.pdf](http://www.irs.gov/file_source/pub/irs-utl/rtrts_deck.pdf). For more information on identity-theft refund fraud, see National Taxpayer Advocate 2013 Annual Report to Congress 75-83 (*Most Serious Problem: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden to Such Taxpayers*); National Taxpayer Advocate 2012 Annual Report to Congress 42-67 (*Most Serious Problem: The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft*).

<sup>93</sup> For written and oral statements of panelists at the two IRS Real Time Tax System Initiative public meetings, see <http://www.irs.gov/Tax-Professionals/Real-Time-Tax-Initiative> (last visited Feb. 13, 2013).

In addition, to stimulate serious consideration and discussion of the issue, we offered the following administrative and legislative recommendations to achieve a system that allows the IRS to perform upfront matching to protect government revenue and improve taxpayer service:

- Provide taxpayers with electronic access to real-time transcripts of third-party information reporting data to aid in return preparation.
- Provide a platform from which taxpayers and preparers could download third-party data directly into commercial tax return preparation software.
- To accelerate the processing of Form W-2 data, develop and implement a one-year pilot to determine if the IRS can screen Form W-2 data as effectively as the Social Security Administration.
- Because almost 98 percent of all information reports are already e-filed, eliminate the March 31 deadline for e-filed information reports.<sup>94</sup> Thus, all information reports, whether e-filed or filed on paper, would be due at the end of February.
- Create a \$50 *de minimis* threshold for corrections, which would eliminate the need to file an amended or corrected third-party information report for any adjustments to income below \$50.
- Further increase electronic filing by reducing the 250 report threshold in IRC § 6011(e) to 50 reports and offer 2D bar code technology for those who cannot e-file.
- Issue direct deposit and other electronic refunds by April 30 and paper checks by May 31.

The proposals included in the 2013 study are meant to serve as a “conversation starter” and are based on research conducted by the Taxpayer Advocate Service, including discussions with impacted stakeholder groups and a review of international tax systems. We attempted to address all identified concerns and risks, but we acknowledge that there will be unexpected challenges and risks before a proposal along these lines is implemented. We recognize that the changes necessary to accomplish an accelerated third-party reporting system require a great deal of forethought, analysis, and stakeholder engagement.

## **VII. Improper Payments of the Earned Income Tax Credit and Other Refundable Credits**

One area of tax administration that has both warranted and received a great deal of attention over the years is refundable credits, particularly the Earned Income Tax Credit

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<sup>94</sup> IRS Pub. 6961, 2013 Update: *Calendar Year Projections of Information and Withholding Documents for the United States and Campuses*, Tables 2-4 (Of the 2,288,516,144 information reports received in calendar year 2012, 2,240,335,726 were received electronically).



(EITC).<sup>95</sup> Most credits merely reduce the amount a taxpayer owes, but in the case of *refundable* tax credits, the IRS may end up paying a taxpayer more than the taxpayer paid in tax, resulting in a “negative” tax. Refundable credits may have become familiar in the context of benefits to low income taxpayers and therefore may be viewed as a form of “welfare.” Nevertheless, these credits are no longer limited to this population but are now available to middle-income taxpayers and businesses as well.<sup>96</sup>

The EITC, enacted as a work incentive in the Tax Reduction Act of 1975, has become the government’s largest means-tested anti-poverty program.<sup>97</sup> Unlike traditional anti-poverty and welfare programs, the EITC was designed to have an easy “application” process by allowing an individual to claim the benefit on his or her tax return. This approach dramatically lowered administrative costs, since it did not require an infrastructure of case workers and local agencies. The Treasury Inspector General for Tax Administration has noted as follows:

Current administration costs are less than 1% of benefits delivered. This is quite different from other non-tax benefits programs in which administrative costs related to determining eligibility can range as high as 20% of program expenditures.<sup>98</sup>

The IRS reports that it paid \$60.3 billion in EITC claims for tax year 2013. If this amount had been paid by another agency that spent 20 percent of program expenditures verifying eligibility, the administrative costs to the government would have been \$12.1 billion – more than 90 percent of the amount of improper payments that the IRS estimates were made.<sup>99</sup>

However, ease of application and the absence of eligibility interviews result in greater overclaims for the EITC than traditional anti-poverty programs. In other words, the front-end administrative costs of traditional anti-poverty programs have shifted to the post-claim compliance costs of the EITC.

A significant positive difference is the EITC has far higher participation rates than other anti-poverty programs (*i.e.*, the percentage of eligible individuals and families who

<sup>95</sup> For a comprehensive discussion of the challenges in administering the EITC, see *Improper Payments in the Administration of Refundable Credits, Hearing Before the H. Comm. on Ways and Means*, 112th Cong. (2011) (statement of Nina E. Olson, National Taxpayer Advocate).

<sup>96</sup> See *e.g.*, the adoption credit (IRC § 36C) and the American Opportunity Tax Credit (IRC § 25A) for low and moderate income taxpayers and the fuel tax credit for purchasers of gasoline used on farms or local buses or of fuels for certain other purposes (IRC §§ 34, 4081(a)(2)(A), 6420, 6421, 6427).

<sup>97</sup> See Pub. L. No. 94-12, § 204, 89 Stat. 26 (1975).

<sup>98</sup> See TIGTA, Ref. No. 2011-40-023, *Reduction Targets and Strategies Have Not Been Established to Reduce the Billions of Dollars in Improper Earned Income Tax Credit Payments Each Year 1* (2011) (IRS response).

<sup>99</sup> Department of the Treasury, *Fiscal Year 2013 Agency Financial Report* 210 (Dec. 13, 2013). The lower bound estimate of improper EITC payments in FY 2013 is \$13.3 billion.

receive the benefit is much greater, at 79 percent).<sup>100</sup> Assuming we want the intended beneficiaries to receive the benefits enacted by Congress, the EITC is a highly effective method of delivery.

Overall, EITC noncompliance is a relatively small portion of the tax gap.<sup>101</sup> EITC overclaims account for six percent of the gross individual income tax noncompliance while business income underreported by individuals accounts for 51.9 percent.<sup>102</sup> Nevertheless, EITC post-claim compliance costs are high and cannot be ignored.

The most familiar estimate of EITC compliance is the Improper Payment (IP) rate.<sup>103</sup> The IP rate for FY 2012 attributable to EITC is 22.8 percent (or \$12.6 billion).<sup>104</sup> This is based on estimates of dollars ultimately misspent (*i.e.*, the amount of taxpayer overclaims *net* of amounts the IRS prevents or recovers).<sup>105</sup> TIGTA has described the EITC IP rate as equal to the total (gross) EITC overclaims less total EITC claims protected/recovered, divided by total EITC claims.

<sup>100</sup> IRS, *EITC Participation Rate by States*, at <http://www.eitc.irs.gov/EITC-Central/Participation-Rate>.

<sup>101</sup> The tax gap is defined as the amount of tax liability faced by taxpayers that is not paid on time. The tax gap can be divided into three components: non-filing, underreporting and underpayment. See IRS, IR-2012-4, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged from Previous Study* (Jan. 6, 2012).

<sup>102</sup> IRS, IR-2012-4, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged from Previous Study* (Jan. 6, 2012). The IRS estimates \$235 billion in individual income tax underreporting for tax year (TY) 2006 with \$122 billion of this amount attributable to business income underreported by individuals as sole proprietors on Schedule C (Profit or Loss from Business) or as farmers on Schedule F (Profit or Loss from Farming). The IRS estimates about \$14.1 billion in EITC overclaims from the NRP from TYs 2006-2008. We determined the EITC overclaim amount by multiplying the overclaim rate by the amount of EITC claims (0.285 lower bound EITC overclaim rate multiplied by \$49.3 billion). IRS, RAS, *Compliance Estimates and Sources of Errors for the Earned Income Tax Credit Claimed on 2006-2008 Returns* (Feb. 12, 2014) (unpublished).

<sup>103</sup> Improper payments include "any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements" as well as "any payment to an ineligible recipient, any payment for an ineligible service, any duplicate payment, payments for services not received, and any payment that does not account for credit for applicable discounts." Improper Payments Information Act of 2002, Pub. L. No. 107-300 § 2351, 116 Stat. 2350 (2002). See also GAO, GAO-09-628T, *Improper Payments: Progress Made but Challenges Remain in Estimating and Reducing Improper Payments*, App. I, at 20 (Apr. 22, 2009) (identifying EITC as the Treasury improper payment).

<sup>104</sup> Fiscal Year 2013 Agency Financial Report – Department of the Treasury 210 (Dec. 13, 2013). The \$12.6 billion amount is the midpoint between Treasury's lower and upper estimate.

<sup>105</sup> IRS, RAS, *Compliance Estimates and Sources of Errors for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 6 (Feb. 12, 2014) (unpublished).

**Figure 6:**  
**Improper EITC Payment Rate Formula**

$\frac{\text{Total Overclaims} - \text{Total Claims Protected/Recovered}}{\text{Total EITC Claims}}$	
<b>Total Overclaims</b>	<i>The difference between the amount of the EITC claimed by the taxpayer on his or her tax return and the amount the taxpayer should have claimed.</i>
<b>Total Claims Protected/Recovered</b>	<i>The amount of EITC overclaims that the IRS prevents from being paid through activities such as math error processing and prerefund examinations or recovers after being paid through Automated Underreporter document matching and post-refund examinations.</i>
<b>Total EITC Claims</b>	<i>The amount of the EITC claimed on all tax returns.</i>

Source: TIGTA analysis of the IRS's Fiscal Year 2012 Executive Order 13520 report

*The 2006-2008 NRP Study Provides a Roadmap for Understanding and Addressing EITC Noncompliance*

While the Improper Payment rate provides us with a consistent net measure of improper EITC payments (*i.e.*, improper payments actually made), it is important to understand the sources of error for total (gross) EITC overclaims in order to develop targeted strategies to reduce the Improper Payment rate. The most recent IRS National Research Program (NRP) EITC results are useful in this regard, because they provide a statistically representative sample from which to draw observations of taxpayer behavior and better understand the sources of EITC noncompliance.<sup>106</sup> Specifically, the IRS Tax Year 2006 – 2008 NRP Compliance Study (hereafter, NRP Compliance Study) data show the impact on compliance of the complex eligibility criteria and the characteristics of the EITC beneficiary population. These findings should drive the IRS's EITC education, compliance, and enforcement initiatives.<sup>107</sup>

<sup>106</sup> The IRS created the National Research Program (NRP) in 2000 to "develop and monitor strategic measures of taxpayer compliance." National Research Program, at [http://www.irs.gov/uac/National-Research-Program-\(NRP\)](http://www.irs.gov/uac/National-Research-Program-(NRP)) (last visited on Feb. 19, 2014). NRP is a comprehensive effort by the IRS to measure payment, filing, and reporting compliance for different types of taxes and various sets of taxpayers and to deliver the data to the Business Operation Divisions to meet a wide range of needs including support for the development of strategic plans and improvements in workload identification. Internal Revenue Manual (IRM) 4.22.1.3 (Apr. 25, 2008).

<sup>107</sup> The NRP Compliance Study estimated the total (gross) dollar overclaim percentage at 28.5 percent or \$14.1 billion (Lower Bound Estimate or LBE). IRS, RAS, Compliance Estimates and Sources of Errors for the Earned Income Tax Credit Claimed on 2006-2008 Returns 7 (Feb. 12, 2014) (unpublished). Lower-bound estimates assume audit non-participants have similar compliance behavior to audit participants with similar characteristics (*i.e.*, in same sampling strata). Upper-bound estimates assume audit non-participants are noncompliant (*i.e.*, exam conclusion is correct). IRS, RAS, Compliance Estimates and

I should point out that the NRP data does not necessarily present a complete picture of the sources of EITC noncompliance because some taxpayers do not participate in the NRP audits for a variety of reasons. However, the NRP audit results are more reliable than typical EITC audits. Unlike the IRS's typical EITC audits, which are conducted via correspondence with a population that has limited literacy and high transiency and thus has a very high no-response rate, 95 percent of NRP EITC audits are conducted in a face-to-face environment in the office or the field.<sup>108</sup> Field and office audits generally have a higher response rate and agreement rate than correspondence audits and thus provide a better opportunity to identify the sources of error.<sup>109</sup> Still, the NRP Compliance Study distinguishes between "known errors" and "unknown errors." It estimates that 30 percent of total possible overclaim returns and 41 percent of total possible overclaim dollars stem from unknown errors (*i.e.*, cases where compliance and errors are unknown mostly because of audit non-participation). Nevertheless, based on audit participants, the IRS believes it can reliably project 8.4 million overclaim returns and \$11.4 billion overclaim dollars to the EITC population.<sup>110</sup>

These findings from the NRP Compliance Study demonstrate that the sources of known EITC errors are numerous, and imply that a one-size-fits-all solution will not work:

- As a threshold matter, many EITC overclaims are less than \$500 (44 percent LBE), and relatively few overclaims are above \$3,000 (11 percent LBE).
- Income misreporting is by far the most common type of error:  
-- 65 percent of overclaim returns show some income misreporting, and it is the

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Sources of Errors for the Earned Income Tax Credit Claimed on 2006-2008 Returns 4 (Feb. 12, 2014) (unpublished). TAS research studies suggest the Lower Bound Estimate more accurately reflects the EITC dollar overclaim rate. A 2004 Taxpayer Advocate Service study of a representative sample of the EITC Audit Reconsideration population found that 43 percent of taxpayers who in the original audit did not respond to IRS contacts, or whose response was received after the IRS deadline and thus was not considered in the audit, had favorable outcomes from the audit reconsideration process (meaning they received more EITC from the reconsideration than from the initial audit itself). This percentage is about the same as the favorable outcome rate for *all* taxpayers in the audit reconsideration sample. Moreover, the non- and late-responders received about 96 percent of the total EITC claimed on the original return. *"This suggests that taxpayers who fail to respond to the audit, or who have a late response, may in fact be eligible for the EITC."* (Emphasis in original.) See National Taxpayer Advocate 2004 Annual Report to Congress, vol. 2, at 29 (Earned Income Tax Credit (EITC) Audit Reconsideration Study). Accordingly, we use the LBE rate throughout this discussion.

<sup>108</sup> The combined no response and undeliverable rate for non-NRP correspondence examinations is 53 percent. An additional 15 percent of taxpayers stopped responding. IRS, Audit Information, Closed Case Database, TY 2012.

<sup>109</sup> TAS, *IRS Correspondence Examinations: Are they really as effective as the IRS thinks?*, National Taxpayer Advocate's Blog: Taxpayer Rights and Taxpayer Burden, <http://www.taxpayeradvocate.irs.gov/Blog/irs-correspondence-examinations-are-they-really-as-effective-as-the-irs-thinks>.

<sup>110</sup> IRS, RAS, *Compliance Estimates and Sources of Errors for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 9 (Feb. 12, 2014) (unpublished).

only error on 50 percent of overclaim returns.

-- The average overclaim on income-error-only returns is \$658.

- Qualifying child (QC) errors occur less than half as often and they are less likely to be the only error:
  - 29 percent of overclaim returns show a qualifying child error, and it is the *only* error on 15 percent of overclaim returns.
  - The average overclaim on QC-error-only returns is \$2,299.
- 8 percent of overclaim returns have *both* QC errors and income misreporting.
- 14 percent of overclaim returns have *neither* QC nor income errors.

Figure 7 shows the five *most costly* error types and their percentages of total overclaim dollars.

Figure 7:

#### Five Most Costly Error Types

Error Type	Lower-bound estimate
Qualifying child errors	40%
Self-employment income misreporting	13%
Filing status errors	9%
Income reporting of investment income and AGI (excluding earned income)	5%
Wage income misreporting	2%

Figure 8 below shows the five *least costly* error types and their percentages of total overclaim dollars. Note that “tiebreaker” errors – where more than one eligible person claims a qualifying child – are now trivial, compared with the 1999 Compliance Study, when tiebreaker errors accounted for 17 percent or more of overclaim dollars.<sup>111</sup> The tiebreaker rules were significantly modified and clarified in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA);<sup>112</sup> the NRP Compliance Study data show the positive impact legislative clarification can have on compliance.

<sup>111</sup> See IRS, *Compliance Estimates for Earned Income Tax Credit Claimed on 1999 Returns* (Feb. 28, 2002).

<sup>112</sup> Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107-16, § 303, 115 Stat. 38 (2001). Tiebreaker rules under EGTRRA stipulate that if a child is claimed by more than one eligible person, the credit would first go to the biological parent. If there are two claims between non-parental family members, the credit will go to the family member with the highest adjust gross income. If two parents do not file a joint return, the credit will go to the parent with whom the child resided for the longest

Figure 8:

## Five Least Costly Error Types

Error Type	Lower-bound estimate
Rules for all taxpayers claiming EITC <i>Having a valid SSN, being a U.S. citizen or resident alien all year, not filing Form 2555 or Form 2555-EZ, not being a qualifying child of another person</i>	1%
Tiebreaker errors	1%
Errors corrected in processing <i>Includes math errors and other adjustments made prior to NRP exam</i>	1%
Rules for taxpayers claiming EITC without children <i>Being age 25-64, not a dependent of another taxpayer, and having a home in the U.S. for more than half the year</i>	0%

*The Interaction of Complex Eligibility Requirements and the Characteristics of the EITC Population Accounts for Many EITC Errors*

Generally, the amount of the EITC increases with earned income, creating an incentive to work.<sup>113</sup> The EITC amount also increases if a worker has one, two, or three qualifying children, but is disallowed if the worker has more than \$3,300 of investment income.<sup>114</sup> The EITC phases out at an income ceiling of \$51,567 (for a married couple

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time. If residency was split equally between two parents, the credit will go to the parent with the highest adjusted gross income.

<sup>113</sup> See Stacy Dickert, Scott Houser & John Karl Scholz, *The Earned Income Tax Credit and Transfer Programs: A Study of Labor Market and Program Participation*, Tax Policy and the Economy, vol. 9, ed. James M. Poterba (MIT Press, 1995); Janet Holtzblatt, *Trade-offs Between Targeting and Simplicity: Lessons from the U.S. and British Experiences with Refundable Tax Credits* (Dept. of the Treasury, 2004) 13 (citing Dickert, Houser & Scholz among academic economists who "estimated that expansions of the EITC between 1993 and 1996 would induce more than half a million families to move from welfare to work").

<sup>114</sup> See generally IRC § 32(i); Rev. Proc. 2013-15, § 2.05, 2013-5 I.R.B. 444; Instructions for Form 1040, U.S. Individual Tax Return 51 (2013).

filing jointly with three or more qualifying children).<sup>115</sup> Detailed requirements govern eligibility and computation.<sup>116</sup>

For purposes of EITC, the definition of a qualifying child has three main components: age, relationship, and residence. The IRS can systematically verify age with federal databases (such as the Social Security Numident database). However, relationship and residence are factual circumstances that often require intrusive inquiries into taxpayers' personal circumstances and are hence more difficult to establish.

- Under the *relationship* requirement, the taxpayer generally may claim the EITC only with respect to a child who is his or her son, daughter, stepchild, foster child, or a descendant of any of them (e.g., a grandchild), or a child who is a sibling, stepsibling, or half-sibling of the taxpayer, or a descendant of any of them (e.g., a nephew or grandnephew).<sup>117</sup>
- Under the *residence* requirement, a taxpayer generally may claim the credit only with respect to a child who lives with the taxpayer for more than half the calendar year (*i.e.*, six months plus one day).<sup>118</sup>

As a practical matter, low income taxpayers have considerable difficulty documenting relationship and residence,<sup>119</sup> because of a lack of clarity from the IRS as well as their

<sup>115</sup> IRC § 32(b); Rev. Proc. 2013-15, § 2.05, 2013-5 I.R.B. 444; Instructions for Form 1040, *U.S. Individual Tax Return* 51 (2013).

<sup>116</sup> A 2009 House committee report provided the following description:

Eligibility for the EITC is based on earned income, adjusted gross income, investment income, filing status, and immigration and work status in the United States. The amount of the EITC is based on the presence and number of qualifying children in the worker's family, as well as on adjusted gross income and earned income.

The EITC generally equals a specified percentage of earned income up to a maximum dollar amount. The maximum amount applies over a certain income range and then diminishes to zero over a specified phaseout range. For taxpayers with earned income (or adjusted gross income (AGI), if greater) in excess of the beginning of the phaseout range, the maximum EITC amount is reduced by the phaseout rate multiplied by the amount of earned income (or AGI, if greater) in excess of the beginning of the phaseout range. For taxpayers with earned income (or AGI, if greater) in excess of the end of the phaseout range, no credit is allowed.

An individual is not eligible for the EITC if the aggregate amount of disqualified income of the taxpayer for the taxable year exceeds \$3,100 (for 2009). This threshold is indexed for inflation. Disqualified income is the sum of: (1) interest (taxable and tax exempt); (2) dividends; (3) net rent and royalty income (if greater than zero); (4) capital gains net income; and (5) net passive income (if greater than zero) that is not self-employment income.

H.R. Rept. No. 111-16, at 519 (2009).

<sup>117</sup> See IRC § 152(c)(2).

<sup>118</sup> See IRC § 152(c)(1)(B).

personal circumstances. In the past, TAS has reported that the “two main problems are inconsistency as to which documents the IRS will accept (a document is accepted in one office, but not in another) and inflexibility in accepting proof (failure to accept other types of documents where the taxpayer cannot provide standard documentation).”<sup>119</sup> On the low income taxpayers’ part, one of the biggest issues is “their tendency to be transient or even temporarily homeless” coupled with literacy challenges.<sup>121</sup> This combination of byzantine requirements with the lack of a home in which to store documents, not to mention the skills needed to read or retain them, frequently results in a lack of documentation.

Given the inherently personal and fluid nature of household living arrangements, a child’s relationship and residence with respect to a low income taxpayer must be validated on a case-by-case basis. Moreover, about one-third of EITC claimants cycle in and out of eligibility each year.<sup>122</sup> Thus, the learning curve for understanding how complex EITC eligibility rules apply to one’s (changing) household situation is very steep.

Despite these challenges, the NRP Compliance Study found that *about 87 percent (LBE) of the qualifying children claimed for EITC are claimed correctly.*<sup>123</sup> That is a credit to the IRS’s outreach and education efforts, and the IRS’s partnership with external stakeholders who work with the EITC population. Of the 13 percent of “knowable” QC errors,<sup>124</sup>

- 76 percent were attributable to the residency test;
- 20 percent were attributable to the relationship test;

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<sup>119</sup> See Leslie Book, *EITC Noncompliance: What We Don’t Know Can Hurt Them*, Tax Notes (June 23, 2003) 1821; Leslie Book, *The Poor and Tax Compliance: One Size Does Not Fit All*, 51 Kans. L. Rev. 1145 (2003), at [http://works.bepress.com/leslie\\_book/8](http://works.bepress.com/leslie_book/8); National Taxpayer Advocate 2002 Annual Report to Congress 50 (Most Serious Problem: *EITC Eligibility Determinations Can Be Made Less Burdensome*).

<sup>120</sup> National Taxpayer Advocate 2005 Annual Report to Congress 106-07 (Most Serious Problem: *Earned Income Tax Credit Exam Issues*).

<sup>121</sup> Leslie Book, *The IRS’s EITC Compliance Regime: Taxpayers Caught in the Net*, 81 Ore. L. Rev. 351, 393 (2002).

<sup>122</sup> See IRS EITC Fact Facts at <http://www.eitc.irs.gov/Partner-Toolkit/basicmaterials/ff> (last viewed February 20, 2014). See also Phyllis Jeroslow, *The Earned Income Tax Credit as an Anti-Poverty Programme: Palliative or Cure?* at 31, 25th Annual Social Policy Review, The Policy Press, Bristol, UK (2013).

<sup>123</sup> The 87 percent estimate was computed using the lower-bound estimate methodology, which assumes audit non-participants have similar compliance behavior to audit participants with similar characteristics (i.e., in the same sampling strata). Upper-bound estimates assume audit non-participants are noncompliant (i.e., exam exclusion is correct). IRS, RAS, *Compliance Estimates and Sources of Errors for the Earned Income Tax Credit Claimed on 2006-2008 Returns 4* (Feb. 12, 2014) (unpublished).

<sup>124</sup> IRS, RAS, *Compliance Estimates and Sources of Errors for the Earned Income Tax Credit Claimed on 2006-2008 Returns 13* (Feb. 12, 2014) (unpublished).



- 7 to 9 percent were each attributable to the age test, an error corrected in processing, an invalid SSN, and the tiebreaker rules;
- 1 percent to a married child; and
- 10 percent to unknown errors (*i.e.*, the taxpayer acknowledged the error but gave no detail, or it was an “operational exam.”)<sup>125</sup>

*Return Preparers Are an Important Factor in EITC Compliance.*

Return preparers play a significant role in EITC compliance, and can facilitate either compliant or noncompliant taxpayer behavior.<sup>126</sup> Congress has recognized this role by imposing on paid return preparers a Due Diligence penalty if they fail to comply with due diligence requirements imposed by the IRS.<sup>127</sup> As Figure 9 shows, paid preparers prepared over half of all returns claiming various refundable credits in recent years.

**Figure 9: Taxpayers Claiming Refundable Credits, Claim Amounts, and Preparer Usage, Tax Years 2010-2011**<sup>128</sup>

Tax Credit	Tax Year	Number of Taxpayers	Average Claim (dollars)	Total Claims (dollars in thousands)	Preparer Returns (percentage)
Earned Income Tax Credit	2011	27,362,193	\$2,270	\$62,119,975	59.3%
Additional Child Tax Credit	2011	20,616,435	\$1,347	\$27,771,740	65.0%
First-Time Homebuyer Credit	2010	373,880	\$6,893	\$2,577,155	53.8%
Adoption Credit	2011	55,794	\$13,474	\$760,365	60.1%
Making Work Pay Credit	2010	106,381,764	\$514	\$54,784,234	53.6%
American Opportunity Tax Credit	2011	12,525,776	\$899	\$11,266,488	55.9%

Unenrolled preparers – those who are neither attorneys, certified public accountants, nor enrolled agents – account for more than three-fourths of EITC returns that are prepared by a paid preparer. This figure is conservative, given significant anecdotal evidence that some paid preparers do not sign the returns they prepare (despite a statutory requirement to do so) and thus are not visible to the IRS.

<sup>125</sup> Note that the total equals more than 100 percent due to multiple errors per child. “Operational exam” is defined as a standard non-NRP exam. Some of the cases selected into the NRP sample end up being worked by regular IRS examination procedures (because during processing some cases are “frozen” and claimed by regular exam processes before NRP can claim them). About one percent of the NRP sample is worked by standard “operational” exams.

<sup>126</sup> National Taxpayer Advocate 2008 Annual Report to Congress, vol. 2, 74-116 44-74 (Leslie Book, *The Need to Increase Preparer Responsibility, Visibility, and Competence*); National Taxpayer Advocate 2008 Annual Report to Congress, vol. 2, 44-74 (Leslie Book, *Study of the Role of Preparers in Relation to Taxpayer Compliance with Internal Revenue Laws*).

<sup>127</sup> IRC § 6695(g). This duty also extends to determining the correct amount of credit allowed. *Id.*

<sup>128</sup> IRS Compliance Data Warehouse (CDW), Individual Returns Transaction File and Individual Master File, TY 2010 and 2011 (through Mar. 2013).

**Figure 10: Preparation of EITC Claims by Unenrolled Preparers in TY 2010-2012<sup>129</sup>**

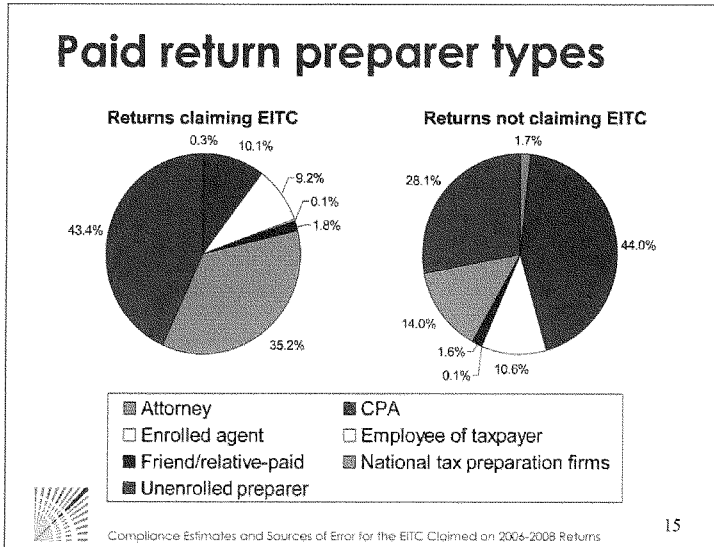
Tax Year	EITC Paid	Count	Total Preparers	Unenrolled Preparers	Percent Unenrolled
2010	\$58,573,186,452	27,627,852	16,464,493	12,430,967	75.5%
2011	\$61,109,934,146	27,816,576	16,549,166	12,198,085	73.7%
2012	\$62,981,818,983	27,081,228	15,132,562	11,523,814	76.2%

The NRP Compliance Study found that 68 percent of returns claiming the EITC showed the involvement of a paid preparer, compared to 55 percent of individual returns not claiming the EITC. (VITA, Tax Counseling for the Elderly, and IRS-prepared returns only accounted for three percent of EITC returns and two percent of non-EITC individual returns.)

EITC returns also differ from non-EITC individual returns in terms of type of preparer. As the chart below shows, unaffiliated unenrolled preparers and preparers in national tax preparation firms are disproportionately active with EITC returns, in contrast with non-EITC returns.

**Figure 11: Types of Preparers Handling EITC and Non-EITC Returns**

<sup>129</sup> IRS, Compliance Data Warehouse Individual Returns Transaction File; IRS, Individual Master File (net of transactions 764, 765, and 768); IRS, Return Preparer and Provider Database (through Nov. 2013) (note that the amounts paid out by the IRS may have been subsequently disallowed in post-refund audits).



Interestingly, the NRP Compliance Study found no statistically significant difference between all self-prepared returns and all paid-preparer returns in terms of the likelihood or magnitude of EITC error. However, variation does exist within preparer types. Unaffiliated unenrolled preparers (*i.e.*, unenrolled preparers who are not affiliated with a national tax preparation firm) are most prone to error, and the difference is statistically significant in some comparisons. Specifically, 49 percent of the EITC returns prepared by unaffiliated unenrolled preparers contain overclaims averaging 33 percent of the amount claimed.

### *Preliminary Recommendations to Improve EITC Compliance*

In summary, the most recent NRP Compliance Study found that:

- High audit non-participation makes it difficult to fully discern the sources of EITC error and the movement in overall compliance.
- Income misreporting is the most common error, although individual errors are relatively low-dollar, and self-employment income misreporting is the most costly component of this type of error.
- Qualifying child errors, especially failure to meet the residency test, are the largest contributor to overclaim dollars, although 87 percent of qualifying children

are claimed correctly.<sup>130</sup>

- Taxpayer-prepared and preparer-prepared returns show similar error rates, but unenrolled preparers have the highest error rates among preparers.

Each of these points leads to specific actions the IRS can take to improve both its understanding of the causes of compliance and taxpayers' compliance behavior. The following recommendations will improve the administration of refundable credits, particularly the EITC, and reduce improper payments without unduly burdening taxpayers or impairing their rights.

*Increasing the EITC Audit Response Rate is Key to Improving Compliance.*

The IRS should focus on how to improve the EITC audit participation rate. Audits are not just about correcting a specific year's tax liability, as every audit provides an opportunity for the IRS to educate the taxpayer about errors on the return so he or she becomes and remains compliant.

TAS research studies have shown correspondence audits have a disproportionately negative effect on the EITC taxpayer outcomes, particularly on the no-response rate. For example, in 2007, TAS reported on a study confirming the discrepancy between actual ineligibility and "flunking" an IRS audit. The study concluded:

Overall, more than one-quarter of taxpayers receiving an [EITC] audit notice did not understand that the IRS was auditing their return. An even larger percentage, almost 40 percent, of the respondents did not understand what the IRS was questioning about their [EITC] claim. Similarly, only about half of the respondents felt that they knew what they needed to do in response to the audit letter.<sup>131</sup>

TAS recently conducted another study in collaboration with the Wage and Investment and Small Business/Self Employed divisions' correspondence exam units.<sup>132</sup> In the study, a test group of about 900 taxpayers underwent EITC audits that involved two or more outbound call attempts. A control group of about 2,500 taxpayers underwent

<sup>130</sup> The 87 percent estimate was computed using the lower-bound estimate methodology, which assumes audit non-participants have similar compliance behavior to audit participants with similar characteristics (i.e., in the same sampling strata). Upper-bound estimates assume audit non-participants are noncompliant (i.e., exam exclusion is correct). IRS, RAS, *Compliance Estimates and Sources of Errors for the Earned Income Tax Credit Claimed on 2006-2008 Returns 4* (Feb. 12, 2014) (unpublished).

<sup>131</sup> National Taxpayer Advocate 2007 Annual Report to Congress, vol. 2, 100, 103-104 (relating to a survey sample designed to achieve an overall accuracy of plus or minus five percent at the 95 percent confidence level).

<sup>132</sup> Taxpayer Advocate Service, *Enhanced EITC Communication Project* (Nov. 2013) (unpublished report, on file with the Taxpayer Advocate Service). See also National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2, 63-90 (*Research Study: An Analysis of the IRS Examination Strategy: Suggestions to Maximize Compliance, Improve Credibility, and Respect Taxpayer Rights*).

traditional correspondence examination processing, which is primarily automated and generally involves no outbound call attempts.<sup>133</sup> When the audit resulted in disallowance of all or part of the EITC claimed on the original returns and when the taxpayer did not agree with the audit findings, a Taxpayer Advocate Service Case Advocate contacted the taxpayer and offered assistance.<sup>134</sup>

Significant findings from the first phase of the study (IRS test and control group audits) include:

- Using internal IRS databases, Exam found a contact number associated with the test group taxpayer in 63 percent (565) of the cases. Nevertheless, Exam successfully contacted the taxpayer in only 24 percent of the test group cases.
- Overall, taxpayers in the test group participated in the audit (rather than defaulting or “dropping out”) somewhat more frequently than those in the control group. The response rate for these taxpayers was 47 percent compared to 43 percent for the control group. (The results are statistically significant at the 93 percent level.)
- Taxpayers in the test group who were successfully contacted participated in the audit much more frequently than taxpayers in the control group (who received no outbound calls). The response rate for these taxpayers was 61 percent compared to 43 percent for the control group. (This difference is statistically significant at the 93 percent confidence level.)

In the second phase of the study, Exam forwarded to TAS 686 cases that had been closed other than as a “no-change” or “agreed” for additional attempts at taxpayer contact and assistance. The significant findings from this phase of the study are:

- To better identify contact telephone numbers, TAS used additional external databases (such as Accurant) and Internet searches that Exam did not use, as well as information from the return filed in the tax year following the audit. TAS successfully contacted 37 percent (243) of its study cases, including 28 percent (186) of the taxpayers that Exam was unable to contact.
- Of the taxpayers TAS successfully contacted, in 44 percent of the cases (87), the taxpayers indicated they were ineligible for the EITC, but only two taxpayers indicated that they understood they were ineligible for EITC prior to TAS contact.

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<sup>133</sup> IRM 4.19.20.1 (May 21, 2013).

<sup>134</sup> Taxpayer Advocate Service, Enhanced EITC Communication Project (Nov. 2013) (unpublished report, on file with the Taxpayer Advocate Service).

- TAS successfully advocated for eight taxpayers to receive EITC for one or more children, usually substantiating the claim with conventional documentation.
- TAS assisted an additional 32 taxpayers with receiving the childless-worker EITC. TAS reviewers discovered that Exam either was not discussing the childless-worker EITC with taxpayers or did not always process the necessary paperwork to obtain the credit.

This study shows that the IRS's current correspondence exam-based EITC audit strategy squanders an important educational opportunity and in some cases actually misstates the dollar amount of overclaims by not making contact with the taxpayer or by not determining whether the taxpayer is eligible for the childless-worker portion of the EITC.

#### *The IRS Needs to Change its EITC Audit Procedures*

Given the literacy and transiency challenges facing the low income population, and the fact that about a third of the EITC population annually churns, the IRS should revamp its EITC audit procedures.<sup>135</sup> Specifically, it should take the following steps:

- Expand its address and telephone contact research;
- Incorporate outbound calls into its examination process;
- Require its auditors to determine the taxpayer's eligibility for the childless worker EITC;
- Require its auditors to explain and educate taxpayers, orally and in writing, in language the low income population can understand, the reasons for the disallowance;
- Enable taxpayers to have virtual face-to-face audit appointments via encrypted videoconference software; and
- When the taxpayer has responded to an audit notice, assign the case to a specific exam employee who will work it to completion.

#### *Matching Third-Party Information Reports with EITC Returns During the Filing Season Can Address the Most Common EITC Errors*

As discussed above, if the IRS could receive third party information reports of income during the filing season, it could identify income misreporting designed to maximize EITC benefits and EITC claims attributable to identity theft. Once taxpayers know the IRS is using this information during the filing season, they will adjust their behavior accordingly. Moreover, if taxpayers or their preparers can download this information, inadvertent omissions of income (e.g., nonreceipt of a 1099 or W-2 form attributable to a taxpayer's change of address) would be minimal. In addition, the advent of payment

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<sup>135</sup> IRS EITC Fact Facts at <http://www.eitc.irs.gov/Partner-Toolkit/basicmaterials/ff> (last visited February 20, 2014).

card information reporting may provide the IRS with better selection of Sole Proprietorship returns for audit, which account for the largest component of income-error EITC dollars.

The IRS and Treasury should prepare a report, in consultation with the National Taxpayer Advocate, which provides a plan and timeline to achieve an accelerated third-party information reporting system, including the ability of taxpayers to access and download, print, or export their information reports.

*Focusing on the Qualifying Child Residency Test Will Improve the Area of Highest Dollar Noncompliance*

Failure to meet the residency test for a qualifying child accounts for the largest volume of overclaim dollars. Given the fact-based nature of the determination of where a child resides for the majority of the year, the IRS should make this issue a key component of its outreach strategy. EITC auditors should be required to pay particular attention to this issue and make significant efforts to explain to the taxpayer how they determine residency and why the taxpayer did not meet the requirement.

The IRS should also immediately use the Form 8836, *Qualifying Children Residency Statement*, which it developed and tested in a TY 2003 initiative to use affidavits to document the residency of qualifying children of low income taxpayers. At that time, the IRS found affidavits more reliable than traditional documentation:

Affidavits were believed to be easier for taxpayers to obtain than official documents or letters. *The results show that affidavits had a higher acceptance rate than the other two types of documents. In each of the tests, about one-half of the records and statements or letters were accepted compared to approximately three-quarters of the affidavits.*<sup>136</sup> (Emphasis added.)

The form walks the taxpayer through the requirements for meeting the residency test and overcomes the difficulties associated with obtaining documentary evidence that low income taxpayers otherwise face. Taxpayers could utilize this form in audits in conjunction with current procedures that allow either official records or letters on official letterhead to document the residency requirement.<sup>137</sup> In appropriate instances, the form could be incorporated into the Due Diligence Preparer requirements (discussed below).

<sup>136</sup> See IRS, *Earned Income Tax Credit Initiatives: Report on Qualifying Child Residency Certification, Filing Status, and Automated Underreporter Tests*, at 14 (2008).

<sup>137</sup> Form 886-H-EIC-2013, *Documents You Need to Prove You Can Claim an Earned Income Credit on the Basis of a Qualifying Child or Children*, requires "photocopies of school (no report cards), medical, childcare provider (provider can't be a relative) or social service records" or "a letter on official letterhead from a school, a health care provider, a social service agency, placement agency official, employer, Indian tribal official, landlord or property manager, or a place of worship that shows the name of your child's parent or guardian, your child's address and the dates that they lived with you."

*Regulation, Testing, Continuing Education, and Oversight of Unenrolled Preparers Are the Most Powerful Tools for Increasing EITC Compliance and Reducing Overclaims.*

Simply stated, unenrolled preparers are the make-and-break point for all EITC compliance strategies. Preparers account for the majority of EITC claims submitted to the IRS, and unenrolled preparers account for three-quarters of preparer EITC returns. Unenrolled preparers have the highest error rate of all types of preparers. If a single unenrolled preparer plays fast and loose with EITC eligibility rules, tens if not hundreds of taxpayers' returns could be in error.

The recently strengthened regulations and increased EITC due diligence penalty under IRC § 6695(g), coupled with a robust preparer compliance initiative and vigorous preparer prosecutions, should shift some preparer compliance behavior. But so long as anyone can purchase off-the-shelf software and hang out a shingle declaring him or herself a return preparer, without any demonstration of competency or any set of ethical rules to adhere to, we will not bring about significant change in EITC compliance.

The low income population is vulnerable to unskilled and unethical preparers. The size of the refund is attractive to payday lenders and others interested only in what fees they can charge, not to mention criminal opportunists. Preparers in this category have no professional responsibility to the tax system. Yet, as numerous studies have shown, they operate in the areas and communities where low income persons reside.<sup>138</sup>

The single most useful step Congress can take to improve EITC compliance and reduce Improper Payments is to enact a regulatory regime that requires unenrolled preparers who prepare returns for a fee to demonstrate minimum levels of competency by passing an initial test and then taking annual continuing education courses (including ethics).<sup>139</sup> The IRS cannot audit this EITC noncompliance out of existence – audits occur after the noncompliance has occurred and, in many instances, after the dollars have already gone out the door. Preparer regulation is prophylactic and efficient.

More specifically, I believe Congress should explicitly authorize the IRS to require unenrolled return preparers to take a competency test and fulfill annual continuing

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<sup>138</sup> For a chilling inventory of studies showing the predatory practices and abuses in this area, see Brief of Amici Curiae, National Consumer Law Center and National Community Tax Coalition in Support of Defendants-Appellants, *Loving v. Internal Revenue Service*, No. 13-5061 (D.C. Cir. 2014.)

<sup>139</sup> Support for preparer regulation as a means both to protect consumers and to improve return accuracy has been broad and bipartisan. The Senate Finance Committee has twice approved legislation to authorize preparer regulation – once under former Chairman Grassley (during Republican control) and once under former Chairman Baucus (during Democratic control). On the House side, the Ways and Means Committee has not considered preparer regulation, but its Oversight Subcommittee held a hearing in 2005 at which numerous preparer groups testified in support of such regulation. In 2010, the IRS began to implement preparer regulation on its own, but the Court of Appeals for the District of Columbia recently invalidated the regulation as exceeding the agency's authority in the absence of authorizing legislation. See *Loving v. IRS*, 2014 U.S. App. LEXIS 2512 (D.C. Cir. 2014). Authorizing legislation would allow the IRS to resume the program that was already underway.



education requirements as a condition of preparing tax returns for compensation. In the meantime, the IRS should offer the testing and continuing education certification on a voluntary basis and condition limited representation of the taxpayer on completion of these competency requirements. The IRS should also continue to develop its EITC preparer strategy, including audits and application of the EITC due diligence penalty, as appropriate. The due diligence form should be updated periodically to reflect current preparer errors and abuses.<sup>140</sup>

## VIII. Conclusion

In my 2013 Annual Report, I stated that the short-term crises of the past year masked the major problem facing the IRS today – unstable and chronic underfunding that puts at risk the IRS's ability to meet its current responsibilities, much less articulate and achieve the necessary transformation to an effective, modern tax agency. The issues I have discussed today clearly illustrate this situation. In this and every filing season, the IRS must carry out its core mission of collecting revenue and helping taxpayers comply with their obligations. At the same time, it must deal with threats such as identity theft, improve its administration of longstanding programs like the EITC, and prepare for the new challenges presented by the ACA.

I am hopeful that the new leadership of the IRS, with continued oversight and support from Congress and the involvement of the Office of the Taxpayer Advocate, can meet these goals. I strongly believe that the IRS can improve tax administration and the fundamental fairness of the system by embracing the Taxpayer Bill of Rights I have outlined here today. Thank you for the opportunity to deliver this testimony.

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<sup>140</sup> For a more detailed discussion of regulation of return preparers, see National Taxpayer Advocate 2013 Annual Report to Congress 61-75 (Most Serious Problem: *Taxpayers and Tax Administration Remain Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined from Continuing its Efforts to Effectively Regulate Return Preparers*).

# Nina E. Olson

## National Taxpayer Advocate

Nina E. Olson, the National Taxpayer Advocate, is the voice of the taxpayer before the IRS and Congress. She leads the Taxpayer Advocate Service (TAS), an independent organization within the IRS, in helping taxpayers resolve problems with the IRS and in working for systemic change in the IRS and the U.S. tax code. TAS has assisted more than two million taxpayers since its inception in 2000.

Throughout her career, Ms. Olson has advocated for the rights of taxpayers, and for greater fairness and less complexity in the tax system. In calling for fundamental reform in 2012, she wrote, "A simpler, more transparent tax code will substantially reduce the estimated 6.1 billion hours and \$168 billion that taxpayers spend on return preparation" and "reduce the likelihood that sophisticated taxpayers can exploit arcane provisions to avoid paying their fair share of tax."

Ms. Olson was appointed to the position of National Taxpayer Advocate in January 2001. Under her leadership, the Annual Report to Congress has become a vehicle for change. It is one of two reports the NTA is required by statute to deliver each year, and outlines the most serious problems facing the taxpayer. Dozens of her recommendations for change have been introduced as legislation since 2001 and fifteen have been enacted.

Ms. Olson is a member of the American College of Tax Counsel, and delivered the group's prestigious Griswold Lecture in January 2010. More recently, she gave the 2013 Woodworth Lecture, sponsored by Pettit College of Law at Ohio Northern University. The non-profit Tax Foundation selected her to receive its Public Sector Distinguished Service Award in 2007. Accounting Today magazine has named her one of its Top 100 Most Influential People in the accounting profession each year since 2004 and Money magazine named her one of the 12 "Class Acts of 2004."

Prior to her appointment as the NTA, Ms. Olson founded and was Executive Director of The Community Tax Law Project, the first independent § 501(c)(3) low income taxpayer clinic in the United States. From 1975 until 1991, she owned a tax planning and preparation firm in Chapel Hill, North Carolina.

An attorney licensed in Virginia and North Carolina, Ms. Olson served as the chair of the American Bar Association (ABA) Section of Taxation's Low Income Taxpayers Committee as well as the Pro Se/Pro Bono Task Force of the ABA Tax Section's Court Procedure Committee. She is the 1999 recipient of both the Virginia Bar Association's Pro Bono Publico Award and the City of Richmond Bar Association's Pro Bono Award.

Ms. Olson graduated from Bryn Mawr College cum laude with an A.B. in Fine Arts. She received her J.D. cum laude from North Carolina Central School of Law and her Masters of Laws in Taxation, with distinction, from Georgetown University Law Center. Ms. Olson has served as an adjunct professor at several law schools.



YOUR VOICE AT THE IRS



## LEVEL OF SERVICE

Mr. CRENSHAW. Thank both of you all.

And let's ask a few questions. It is interesting to me to hear both of you all talk about the fact that one thing that IRS doesn't do very well, and that is answer the telephone. We just had the Commissioner before us, and it was one of my main concerns as I talked to him.

I know it is always easy to just say, if we had more money, we could hire more people, we could answer the phone more. But as I told him, when you have \$11.3 billion, then you have to decide how to spend the money. And it seems to me that one of the priorities ought to be customer service. When you look through the entire budget, somehow, some way you ought to be able to find the money to do the things that are most important. And if that is the—it is kind of the face of the IRS, answering the telephone. If you only get half the calls answered, and when you get answered, you wait 20 minutes—somewhere, somehow, in all of that \$11 billion, there ought to be money.

I told the Commissioner, it bothered me to find \$63 million were paid out as bonuses, reversing a decision that his predecessor had made because there wasn't enough money. But those are the kind of priority decisions that are being made, and that is what we talked about today.

So maybe, particularly Ms. Olson, maybe as the Taxpayer Advocate, as you advocate for those people that are trying to get through to the IRS, maybe there are some things that you can do as you look through that \$11 billion and say, here is an idea about how you could save some money here, whether it is in your computer contracts or your rentals.

I know they will say they are saving money, they are doing—and I appreciate that, because it is tough. But, still, it seems like you have to do the most important things first of all. I hope maybe both of you all can assist us in finding places where there is a little more money to move to the customer service side, and we will see how that goes.

## IMPLEMENTATION OF RECOMMENDATIONS

Let me just very quickly ask you all, because we have these recommendations that were made, particularly Mr. George, we have the scandal going on and the recommendations that we made—and each of you actually made them, and the President said they are going to implement those.

Tell us how the IRS is doing in implementing each of those recommendations, in general. And tell us, do you believe that some of the groups that are applying for tax-exempt status, are their people still being subjected to this kind of bullying and scrutiny? And then, finally, what work do you plan to do to kind of make sure that this doesn't go on any further?

So maybe each of you could kind of touch on that.

Mr. GEORGE. Thank you, Mr. Chairman. If I may start first.

The IRS has reported to us that they have adopted all of the nine recommendations that we issued in our report on the inappropriate treatment of certain groups seeking tax-exempt status. We are in

the process now of engaging in a review to determine the adequacy of the corrective actions that the IRS purports to have taken. We are in the middle of that. I don't have a deadline yet as to when we will complete that.

But one of the issues that we did recommend was catching up on the backlog of these applications that were still outstanding. And so, as my comments suggest, there are still outstanding applications for groups seeking an up or down from the IRS. I don't know, I wasn't here for the entire portion of the Commissioner's comments, but he, I know, in private has acknowledged that that is the case and that is a priority, but our report will give a thorough response as to the adequacy of their response to our recommendations.

Mr. CRENSHAW. Thank you.

Ms. Olson.

Ms. OLSON. We have been really closely focusing on the process of getting an exempt-org application through, which creates some of the backlog, the amount of review that they were doing or the steps that they were taking. And we have been working very closely with them.

We have also trained my employees so they do better advocacy when they get cases in. And we have seen a significant number of cases. We have issued a significant number of taxpayer assistance orders on these cases, including several that involved (c)(4)s where we felt we were not getting the attention. Most of it was timeliness, getting a decision.

Something that my organization really focused on was the key point in Mr. George's report, where the frontline employees were asking for guidance on these issues for over a year, and no guidance was coming back. And we found that the Exempt Organizations function had no process for tracking the age of these guidance requests, for tracking the requests and saying, this is 3 months old, this is 6 months old. And when you leave employees to their own devices for a year and the backlog is continuing and continuing, they are going to come up with a solution. And we all know what that solution was: a BOLO list.

And so we have really been focusing with them to be responsive on their guidance, to track the guidance so they have the management controls in place, and, as well, to look at their process and say, what do we really need to know?

#### 501(C)(4) DRAFT REGULATION

I would comment, if I could, on the prior discussion about the regulations. I spent a fair amount of time over the last week really looking at the proposed regulations, and what I saw in that was the IRS responding to a recommendation of mine and I think Mr. George's, to get greater clarity, see if there are some bright-line tests you can do. But when you go to the bright-line tests, there are winners and losers, and you have that tradeoff of doing facts and circumstances, which is subjective in a way, versus bright-line test, which is objective but you are going to get some results that we may not want to get.

So I view these as an opportunity to begin a dialogue with people and hear back what the country really wants in these organizations.

Mr. CRENSHAW. Well, it is interesting to hear that perspective, because I do think, as you probably know, they are expecting 100,000—they have already had over 90,000—comments on one of the most controversial, toxic proposals ever been made. The good news from hearing the Commissioner say, at least in his opinion, they wouldn't be put in place anytime soon, but he didn't really say when.

But I think your point that there ought to be a lot of dialogue about that, because it certainly may have a chilling effect on these elections coming up now. And it certainly is arguable that people's freedom of speech could be limited, so it is very important, I think, as we go down that road. So thanks for that.

Mr. Serrano.

Mr. SERRANO. Thank you.

And thank you both for your testimony.

#### TIGTA INVESTIGATION RESULTS

Mr. George, your lead investigator reviewed 5,500 emails and concluded that there was no indication of political motivation, yet you failed to mention this until months after your audit was published. Furthermore, you never mentioned that progressive groups were targeted for scrutiny, as well. Your report repeatedly emphasized the Tea Party and other conservative groups while using the term "other" to refer to the two-thirds of the applications that were examined that did not involve Tea Party groups. External studies of similar information have found that terms like "progressive" and "Occupy" were also used as part of the inappropriate criteria in subjecting groups to extra scrutiny.

Are you concerned about how your initial report has been used? Do you think you should have been more forthcoming or comprehensive in your analysis? At last year's hearing, I thought that you said you planned to take another look at the groups. Have you done so?

And I should have prefaced my comments by saying that I join my colleagues in denouncing anything that went wrong, in terms of scrutinizing people and groups. But your report indicates basically that it was the Tea Party when, in fact, it has been proven that there were other groups. And we want to know why you omitted that and why you did not clarify later on when it was known not to be the case.

Mr. GEORGE. There are obviously a number of issues there, and I beg your indulgence, Mr. Serrano; I may ask you to repeat, you know, one or two of them.

But let me start with the initial comment that you made, and that is about the 5,000-plus emails. It was during the course of the initial report when I was informed by staff that there existed a, quote/unquote, "smoking gun memo," which I haven't seen, which perhaps—which purported to say, hey, IRS, do this as it relates to the groups that were the subject of this, for lack of a better word, poor treatment by the determination unit in Cincinnati and, as we subsequently learned, some of the people in Washington.

My auditors indicated to me that they did not have system access to employee emails. My Office of Investigations did have software and access which would allow them to do a quick-scan search to see if that memorandum existed and could be located.

And so I did not learn about the memo that you noted in your comment until I was literally sitting in a hearing, I believe it was before the House Oversight and Government Reform Committee, and so was not aware that that assertion was made by the Deputy for Investigations. And I am not going to say that it is invalid in its conclusions, but I was just as surprised to learn about that conclusion as many others were.

So it is not that I was hiding anything; it was that I was unaware that that review of the documents had been completed and that that was the opinion of that member of my staff.

Now, as it relates to progressive groups——

Mr. SERRANO. So this was a member of your staff who came to this conclusion but didn't tell you?

Mr. GEORGE. Did not tell me directly, correct. That is correct.

Now, as it relates to whether progressive groups, you have to keep in mind, sir, this was an extraordinarily fluid period in which we found ourselves. And it was literally 6:30 p.m. the night before my first testimony before the Senate Finance Committee in which my former chief counsel indicated that there was a hidden tab in one of the documents that the IRS had supplied to us that indicated that there were other be-on-the-lookout lists. At that time, we had no idea until then, at least I didn't, that it existed, but we certainly did not have any indication as to how they were being used.

Now, from the outset of our review, we did know that groups with the names "Tea Party," "9/12 project," and "Patriot" were being identified using BOLOs and other criteria and that the IRS had set those aside for special processing.

Now, when we learned about the existence of these other BOLOs with "progressive" and a few other names on it, there are two factors. One—and this is the key—Title 26, Section 6103 of the United States Code has criminal penalties if I or anyone else with access to that information releases the names or, in effect, its tax-return information, with very limited exceptions. So the Chairman of the House Ways and Means Committee can receive that and the Chairman of the Senate Finance Committee can receive that information without restriction. No other committee, including this one, has access to that information. And if I were to reveal that information, not knowing, one, whether they were protected by Section 6103, could be subject to penalty.

And so in the late hour of receiving that information and during the course of that period while we are trying to determine what, if anything, the IRS did with this information, I felt it best to—we had our facts in place before opening up what could have been a big issue and what could not have been a big issue; we did not know at that time.

And, lastly——

Mr. SERRANO. Yeah, but let me tell you what troubles me about your testimony. It seems, unless I am hearing it incorrectly, and that is possible, that you knew early, according to your report, that

certain groups were being targeted, but you found out other things the night before you were ready to testify. And so I have to ask myself, how come you were not aware in your investigation, in the ongoing investigation, that other groups and other issues were at play?

It seems to me from what I heard from you on two occasions is that, right before you were ready to testify, you found out about this or found out about that or were told that this was taking place or not. Yet my big question to you is, are you now ready or have you done anything in the past few months to say more than the Tea Party was targeted, if you will?

And remember, remember, sir, that I am one of those liberal Democrats who denounced this practice if it did exist, while also saying that there are people who have misused these breaks they get by not having to put forth who their donors are. And that is at the bottom, or at the center of the problem. So you are not talking to one who is defending everything that happened.

But it seems to me that you are not telling me either everything you know now or everything you have done to correct the misconception that went out there that only certain groups were targeted, when, in fact, that is not what happened, and that has not been the history of this country anyway.

Mr. GEORGE. I understand what you are saying, sir, but, there is something that I neglected to mention at the outset of my response. And that is, the very evening, so it must have been around 7:00 p.m., the night before that first testimony, I instructed my auditors to open up an audit to determine how these other groups were treated. And we are in the process of engaging in that review.

Now, just to be clear, there is an ongoing FBI investigation, and so we are restricted in terms of the people to whom we can speak—

Mr. SERRANO. About all groups or about the other groups, as you refer to them?

Mr. GEORGE. About the previous—the existing—the initial group of people that we identified.

But we are doing an audit, and we have spoken to a few people who have already gone through that process, but I don't have a due date for that.

And I also need to stress, too, sir, that the BOLO list, the be-on-the-lookout list, that we identified, some of which had these progressive groups listed on them, our mandate was to look at the political advocacy or the campaign activities of these groups, approximately 298 of them, and only 3 had the name "progressive" in them.

And I have to again—I have made this point before. I was not in a position to determine, just because a group had the name "progressive" in it, automatically meant that it had one political affiliation or persuasion or another. That was not the purpose of this review. Others interpreted it that way. That certainly was not in our report nor in any of my public comments. I have never said that just conservative groups were targeted.

Mr. SERRANO. Okay. Let me just say this to you. I think that your department made a grave error in letting people believe that only certain groups were targeted. Because now, even if you fix

that and get to the bottom of the truth, the fact is that there is a political issue in this country that is running amok about only certain groups or one certain group being targeted. And we are going to hear about this until the November elections. That is a fact. That is a fact. That is why there will probably be a thousand more hearings about the IRS, and most of them will focus not on the budget but on what happened here.

So I just hope you understand that, by going the way you did, you might have helped to create this kind of a situation.

Mr. GEORGE. If I may, though, Mr. Serrano, because the one thing that is getting kind of lost in all this, my audit was not formally complete before Lois Lerner spoke before a group in which she planted a question to ask about this.

So it was someone from within the IRS who acknowledged that they engaged in this inappropriate behavior and treatment. The IRS had full access to our audit months before it was released, and they did not question the findings that we ultimately released, and of course then preempted us in terms of releasing that information, which is unprecedented.

And so it is not as if we intentionally went out of our way to cast a pall on any particular, group. But they acquiesced in this, sir.

Mr. SERRANO. Okay.

Sorry, Mr. Chairman. I know I went over.

Mr. CRENSHAW. No problem. We will have time to pursue that.

Mr. Yoder.

Mr. YODER. Thank you, Mr. Chairman.

And thank you both for coming to testify today. We have had an eventful morning, both visiting with the new Commissioner and then certainly hearing your updates on what is going on at the IRS.

Certainly, the last year or so has put the IRS and their rule-making authority on the front page of nearly every paper in America. And I think many Americans are concerned to this day about the trust deficit that lies between those who are to enforce the law fairly and impartially. And we know that hasn't been occurring.

And I know, Mr. Serrano and Mr. George, you had a dialogue here. Your point was one that I was going to make, in that I first learned about this back in May of 2013 when Ms. Lerner came out and essentially apologized, said it was inappropriate and made comments to that regard. And so I think that regardless of the original motives—and I think that is what we are still trying to determine, is how all this happened, who put these things on, and motivations.

Let's talk about what has happened since then. And we are going to go back and relitigate who did what, and we have to continue to do that. But in this moment I, at least, want to move forward a bit and say, what are we doing to ensure that this doesn't happen again? We have talked about the nine recommendations and their implementation. You have, in your testimony, both written and in answer to the chairman's questions, stated they are following the nine recommendations.



## 501(C)(4) DRAFT REGULATION

I would like to talk about the 501(c)(4) rules that are now being proposed. There is going to be legislation before the House on this. Interestingly, this has become a bipartisan moment of condemnation. You have the ACLU arguing that these are essentially putting a muzzle on public speech, and you have some liberal and conservative groups doing this.

I would like to know, are the 501(c)(4) rules that the IRS is proposing, are those the result of your recommendations? And if not, where are they coming from?

Mr. GEORGE. One of the proposed recommendations did come directly from our audit report on inappropriate treatment of groups, and that was we proposed that there be guidance on how one should measure the primary activity of the 501(c)(4). All of the other provisions within the proposed rule we have had no role in developing, sir.

Mr. YODER. As these rules are developed, is it your opinion that the Treasury Department can finalize an IRS rule without the approval of the IRS Commissioner?

Mr. GEORGE. I am not privy to the procedures that the Treasury Department follows, except to say that for over 50 years there have been guidance or a directive issued by the Secretary of the Treasury, who has deemed that it is the Assistant Secretary of Treasury for Tax Policy who has the ability to determine the final position of the Department of the Treasury as it relates to Internal Revenue Code or tax policy. And so I would have to defer to them in response to that question.

Mr. YODER. So you are not aware of an instance where the Treasury Secretary would make a rule or regulation in this regard without the consent or the participation of the IRS Commissioner?

Mr. GEORGE. As I have never been a part of that, I can't definitively state it.

Mr. YODER. Okay.

Mr. GEORGE. But one can assume that he would seek—he or she would seek guidance from the Commissioner.

Ms. OLSON. Sir, the current proposed rules are submitted under the signature of the Deputy Commissioner of Services and Enforcement in the IRS. So, I don't know who signs the final rules, but that is whom the proposed rules are signed by.

Mr. YODER. Regarding, sir, your recommendations on how to fix this problem, do you believe if the IRS follows the recommendations of the Inspector General that Congress could sleep at night, they could be rest assured, that the American people could be rest assured and sleep at night, knowing that there is no possibility that agents within the IRS could utilize ideology or some other perspective that goes against their mandate that would target individuals in any way, both as individuals for audits or groups for audits?

How ironclad are these reforms and these changes to ensure—because, sir, it is not just on this issue. We have people—essentially, there is a chilling effect across the country now, a fear of individuals that if they even got involved politically and endorsed Mr. Serrano or the Chairman or me or made a donation, that now they

are on a list, and that means that, maybe not today, but some other administration might utilize the subjective powers that exist, that human individuals have, that can be riddled with fraud or error or malfeasance, that they could use that to subject them to an audit in the future. And now they have to worry every time they get one, why are they getting an audit?

How do we fix that?

Mr. GEORGE. Well, allow me to answer your question, Congressman, by saying we are dealing with human beings.

Mr. YODER. Right.

Mr. GEORGE. And so we still officially have not had a chance to take a formal review of the implementation that the IRS says it has adopted. And we are going to go one by one through each one to determine to what extent they have complied with what we recommended and any ways that they may have diverted, improved, or not met up to that recommendation.

But this is somewhat of an aside, it is an ironclad rule that IRS employees are not supposed to access the tax-return information of people that they officially have no responsibility to work on that particular case, and yet on a daily basis they do that, some of them. Not a lot, but some of them do. So you could have the most ironclad rule in place, but you are dealing with human beings, who are imperfect.

Mr. YODER. I think this is why a lot of Americans are concerned about the IRS getting involved in their healthcare decisions and determining whether they have the proper health insurance to meet Federal mandates. And having that sort of relationship that they might think of with their doctor or someone else in the healthcare world now with an IRS agent I think scares a lot of people that this agency has become too powerful and it has too many opportunities to commit these types of anti-freedom, anti-American type of actions.

So we are going to continue, hopefully in a bipartisan way. I know my colleagues on both sides of the aisle are concerned about this, because it can happen as easily to a conservative group as a liberal group or a group based upon religion or race or anything. And so we have to rout this out, no matter where we are, and make sure this doesn't ever happen again and that people don't feel like it could happen. Your recommendations are an important part of that, and we will look to move forward on additional recommendations as we try to fix this problem.

#### TAX COMPLIANCE

The second topic is one which has come up today, both in the Commissioner's hearing and your hearing, is what is the IRS doing to ensure that it has better resources to deal with taxpayer concerns and complaints, to ensure that the phone is being picked up. The Chairman made that comment. Others have made a comment regarding your data, that it is not being—the responses are pretty weak in terms of handling concerns for consumers.

I would like to maybe turn this question a little bit in that, is the problem that we have not enough people to answer all of the questions and concerns that taxpayers have? Or is the problem that the Code is so cumbersome and riddled with exemptions and

loopholes and problems that average, everyday, working Americans couldn't possibly attempt to figure out on their own and so they have to hire accountants and lawyers? And we have 4 million words in this Code, and it grows, you know, by the second with the regulatory side as well.

I guess, is the problem that we need more people to answer the problems Americans have with the Code, or is the problem in the Code itself?

Mr. GEORGE. Yes. It is all of the above, Congressman. And I will defer to Ms. Olson in a moment, but it is a zero-sum game here.

I mean, they have a finite amount of resources. They have to make sure that the American people understand how to comply with the Tax Code. It has been my belief and findings of many of our audit reports that it is important people understand what the rules are. If the IRS—and this is a key component, and I alluded to this in the testimony—had access to third-party information about the income of people who have tax-reporting obligations, that increases dramatically the compliance rate.

I use this figure, and I believe I have in previous testimonies before this committee, but it is so important that I feel I have to repeat this. Again, there is a high correlation between tax compliance and third-party information reporting and withholding. The IRS itself estimates that individuals whose wages are subject to withholding report 99 percent of their wages for tax purposes. Self-employed individuals who operate nonfarm businesses are estimated to report only 44 percent of their income for tax purposes. And the most striking figure, and while it is dated, it is the most up-to-date information that we have: Self-employed individuals operating businesses on a cash basis report just 19 percent of their income for tax purposes.

So if the IRS had the ability to gain more information from third parties to attest to the income of the taxpayer, you would have a massive positive impact on reducing the tax gap and increasing the revenue that is due to the Federal Government.

I want to leave enough time for Ms. Olson to respond, but you have to have enforcement. That is the second aspect of it. So the IRS has to be in a position—and whether it is by correspondence audit—most people don't realize that if they receive a letter from the IRS questioning their income tax or their tax return, that is an audit. An audit is not just some IRS person coming to your office or your home and sitting across from you and going line by line through receipts and what have you. And, also, a telephone call from the IRS making the same inquiries, that is an audit.

So if you don't have those individuals in a position to do that—and most people who are contacted by the IRS do respond. So if they had more resources, more people to be able to do that, I think it would have a very beneficial impact on revenue collection.

Mr. YODER. Ms. Olson.

Ms. OLSON. If I may, I think there are a number of things operating here.

One is the sheer volume of the work that the IRS has undertaken. Just even its core work has increased dramatically in the last 10 years. The number of phone calls we have received has increased by 53 percent between fiscal year 2004 and this last fiscal

year. So just the volume has increased. Our taxpayer service budget hasn't increased that much to be able to meet the demand that taxpayers have.

In terms of what the IRS could do to get savings in one place and move them to these taxpayer service needs, I think you have to look at the appropriations format itself. We have the two categories of service and enforcement and then a number of others like IT, and it is very difficult to move dollars between those categories.

And in the taxpayer service category is essentially the filing season. So all of those 150 million individual returns and 10 million business returns have to be processed, and that is the big chunk of the taxpayer service budget, and whatever is left over is for the phones.

And, in fact, this last year, one of the reasons why the IRS was able to get its phone level of service even up to the abysmal level of service that it was by taking people off of answering the phones for the automated collection system, where taxpayers were calling in to say, we would like to pay you money. We took them off of that system and put them on the regular 1040 line just to answer the calls during the filing season. If we hadn't done that, we would have been in much worse shape during the filing season.

I think that there are lots of things that the IRS does—I mean, I write a 500-, 700-page report every year identifying things that the IRS could do better. And I think one of the things that I spend a lot of time with and I would encourage this Committee to really urge the IRS to look at is the work that they do up front that creates downstream consequences, that because they are not addressing issues correctly up front or resolving the whole issue up front, you are having many more touches downstream. And that wastes resources. And often those downstream resources are higher-graded employees than the person at the first line of contact. And my office has done a number of studies actually tracing things through the process to show what work is generated by not getting that right answer up front.

So I think there is a lot of work that can be done in that area, and I think we should look at what are we categorizing as enforcement versus service, do we have the right allocations between the budget categories, and things like that. But the bottom line is the amount of work. Leave aside Affordable Care Act, leave aside anything that is new. Just the volume of returns that are coming in.

And I would say one last point. After this recession, we are seeing more and more people becoming self-employed. They are not being hired back as wage earners. They are either putting themselves into business—and so that issue of unincorporated self-employed people not reporting becomes a larger issue for our tax gap and our business going forward.

There is a huge taxpayer service side on that component, too—educating people, being out there, talking to them about their responsibilities, et cetera. It is not just all enforcement that brings in compliance.

## TAX CODE COMPLEXITY

Mr. YODER. Well, I appreciate both of your comments on that topic, and it is one that requires a lot of study and certainly changes from Congress.

I would say, Ms. Olson, that the biggest upstream factor of all this is—you know, you mentioned dealing with problems upstream and not letting them continue to have to cause problems down the road and have more individuals have to touch it more, staff have to deal with it. The biggest upstream issue I think is the complexity of the Tax Code.

Ms. OLSON. Uh-huh.

Mr. YODER. If we had a simplified Tax Code, one in which taxpayers knew the obligations they had, they were very clear and easy, it would not only be easy for taxpayers, it would be so much easier on the enforcement side. It would require less people. It would require a smaller budget for the IRS.

And so I don't think you are going to see a lot of us say, you know, the answer for tax complexity is we just need more staff, we need more bureaucrats. That is not going to be the angle I think we are going to take. It is, how do we simplify the Code to make it easier on taxpayers and easier to enforce?

Mr. George.

Mr. GEORGE. Mr. Yoder, I would just—because Ms. Olson raised a very important point, and I don't know whether or not this was going to come up later. But one of the unintended consequences of the IRS having to shift people from one function to answer telephone calls, one of the areas in which they do this is especially troubling because they take people who were working identity-theft cases, who are working to help identity-theft victims, and literally having these individuals stop in midstream and move to telephone answering, how do you complete a return and what have you, which causes immense delays in helping victims of identity theft, which, as members of this Committee know, is a massively growing problem and, especially if you are the subject, if you are the victim involved, is very frustrating.

And so it is just a point, again, of it being a zero-sum game. They need resources to do it all. This ACA role, most Americans have no idea of the massive role that the IRS is going to play in the implementation of the Affordable Care Act. And the IRS once again will have to make some tough choices as to what to focus upon.

Mr. YODER. Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you.

I don't have any further questions, but I want to make a couple comments.

## 501(C)(4) DRAFT REGULATION

One, Mr. Yoder, you asked about when could they finalize this rule. If you look at the Administrative Procedure Act, there is nothing to stop the IRS from finalizing the regulation the day after they have the comment period end. Now, that is not practical, but it is procedurally possible. And we heard the Commissioner say that he didn't think that was going to happen. That is, kind of, his opinion.

But I think, in light of what Ms. Olson said, I think it is clear, with all the implications that that has, that would be, I think, outrageous if that were to happen. This needs to be talked about, thought out, discussed, whatever. And I hope that is the plan as they receive these, literally, 100,000 comments.

#### SPENDING PRIORITIES

The other thing I would just say, based on—you know, we talk a lot about how much money the IRS needs. And everybody talked about it earlier, you need money to provide services. But one of the problems, we get criticized from time to time, people say, well, you are punishing the IRS, but you are really punishing the people. We are not here to punish anybody. When we asked the Commissioner, how are you spending the money—and then when you look back and you see millions of dollars wasted on lavish conferences, you see the harassment that has gone on.

It was back in 2010, I think, that I think the appropriations to IRS was more than they asked for, and yet that is when all the horseplay and harassment started. In fact, as I recall, some of the money that was being spent on the conferences, since they had a little extra money, they just went ahead and spent it. And then there were times when they would ask for more money, the enforcement would be asking for more money, while money was being wasted somewhere else.

So I don't think this subcommittee or the Appropriations Committee ever wants to punish anybody, but I think this Committee wants to make sure that, just like your role, Ms. Olson, that we are advocates for the taxpayer. And when we see the money being misspent or spent on the wrong priorities—and, as Mr. Yoder said, it might be nice to simplify the Tax Code. If you got it really simple, you wouldn't even need the IRS anymore. You would have a fair tax, as they say.

But I don't know whether it is harder to appropriate more money to the IRS or to simplify the Tax Code. Neither one of them is very easy. But we are actually working on both of them.

But I just wanted to make those comments.

Mr. Serrano, do you have any final questions or comments?

Mr. SERRANO. No tax is good tax.

Actually, I have three questions that I am going to briefly put into one question.

One is about you. How do the taxpayers make their way to you? How can we better make taxpayers aware of your existence? Because you have a lot to offer, and yet the Advocate is not seen on a daily basis or heard from, except maybe before Congress. That is one.

Secondly, I understand that you started your career when the Earned Income Tax Credit began under President Ford. So could you tell us a little bit about that program? Because that gets a lot of grief in Congress also, because sometimes people get it who don't deserve it. And, you know, how does that compare to all the other people who are overseas and in other places who don't pay any taxes at all?

So that is the question in a couple of parts.

## TAXPAYER ADVOCATE SERVICE

Ms. OLSON. Well, first, in terms of getting in touch with us, as you all have mandated in the law, we have one office, at least, in each State. And I have to thank you for that, because we are probably the only part of the IRS that really has one office in each State.

And we try to keep the cases that are worked, that arise in the State in our office there. I guess there is an exception right now for Florida because we are so inundated with identity theft that my employees in Florida would only work identity-theft cases, and I think they would kill themselves if that is all they were doing. So we spread some of them out throughout the United States.

And my local taxpayer advocates work very closely with taxpayers. They are in the news; they work with local media to make sure that the groups know about us, taxpayers know about us. And they have a requirement to reach out to at least 40 grassroots groups in their locale every single year, and 40 different ones, to let them know about us, whether it is domestic violence shelters, homeless shelters, small-business groups. You know, they go to trade associations for truckers. It is very creative, what they do to let people know.

So we can always do more. We enjoy working through the congressional offices, and we are getting more information out about our organization, getting you all some posters and brochures.

## EARNED INCOME TAX CREDIT

I would say about the Earned Income Tax Credit that in my testimony for today we shared some information of some recent results of IRS audit data that shows the sources of the error. We have the improper payment rate, but what is really important in order to move that improper payment rate, lower it, is understanding what is causing these errors. How much of it is fraud, but how much of it is just the complexity of the statute?

And it also helps the IRS learn how to educate taxpayers better, and also go after preparers. One of the things that we know is that unenrolled preparers, the category of preparers who are the ones that are not CPAs, attorneys, or enrolled agents—you know, just anybody can hang up a shingle—they prepare the vast majority of EITC returns that are prepared by preparers. About 60 percent of EITC returns are prepared by preparers, and 75 percent of those prepared returns are prepared by these unregulated people.

One thing that I would like to say about the EITC, I know that we focus on the improper payment rate, but the EITC, to administer it costs about 1 percent of all of—it is a very low-cost program for the IRS to administer. And that contrasts to food stamps or welfare or anything like that, which has caseworkers, et cetera. Food stamps and welfare may have a lower error rate. Where we have our high cost is in the improper payment rate. But if you look at error and cost of administration, it really evens out.

I am not defending the improper payment rate, and I have real pragmatic suggestions about how to address that. But I am just saying, to put it in context, there is a cost one way or another in these kinds of benefit programs. And it is cheap to administer it

through the Internal Revenue Code, but the cost is on the improper payments side.

Mr. SERRANO. Thank you so much.

Mr. CRENSHAW. Well, thank you both, if that answers the question.

Time has expired. Thank you all. We were having such a good time, time just flew by. But thanks for being here. Thanks for all the work that you do.

And, with that, this hearing is adjourned.



**Financial Services and General Government Subcommittee**  
**Hearing on Internal Revenue Service Oversight**  
**for the Treasury Inspector General for Tax Administration**  
**J. Russell George**

**Questions for the Record Submitted by Chairman Ander Crenshaw**

*Reporting Requirements*

In addition to delaying the employer mandate, the Administration also delayed the reporting requirements for insurers and employers, including State and local governments.

**Question:** How will the IRS know who is eligible for a premium tax credit in 2014 if the IRS does not have information about who was offered employer-sponsored plans, the affordability of those plans, and the value of those plans?

Due to the delayed information reporting requirements for employers, the IRS will not have key information during the 2015 filing season needed to verify whether an individual was eligible to claim the Premium Tax Credit beginning in 2014. We have a planned review that will evaluate the adequacy of processes and procedures used by the IRS to verify the accuracy of individuals' claims for the Premium Tax Credit and compliance with the individual health coverage mandate. This will include identifying actions the IRS plans to take in response to the delayed employer information reporting. We will initiate this review in May 2014 with reporting in Fiscal Year 2015.

*FY 2014 Budget*

The 2014 omnibus provide TIGTA with \$7 million above the request.

**Question:** How do you plan to use these funds, in particular the \$5 million made available for two years?

TIGTA plans to use the additional funding in three key areas: 1) restore staffing to pre-sequestration levels; 2) increase training expenditures for auditors and special agents to meet required standards; and 3) upgrade and improve our technology infrastructure.

The hiring freeze due to sequestration resulted in a net loss of approximately five percent of TIGTA's staff. Additional funding will allow the Office of Audit to hire auditors and perform more on-site audit work at IRS locations. In addition, the Office of Investigations will be able to hire agents with specialized skills in areas such as digital investigations and procurement fraud. Other personnel with new and specialized skills can also be hired as TIGTA replaces outdated systems.

In addition, TIGTA will provide specialized training in Fiscal Year 2014 to its audit and investigative staff to meet required standards. Due to budget constraints, most auditors only received 20 of the 80 hours of Continuing Professional Education in Fiscal Year 2013 required by *Government Auditing Standards* every two years. As a result, the balance of the required training must be obtained in Fiscal Year 2014. The Office of Investigations is required to provide its firearms and defensive tactics instructors with periodic updated training and it cycles its special agents through mandatory training every third year. TIGTA must deliver training each year to keep its agents on cycle. Due to the budget constraints, much of the required training was not taken in Fiscal Year 2013.

Finally, TIGTA will use some funding to upgrade or replace technology used to support its audit and investigative activities, including updating selected servers and routers, and law enforcement mobile communication capabilities for its investigative staff.

**Question: Do these funds help your office produce more reports, conduct deeper investigations, or provide better security for IRS employees?**

Yes. As additional staff is added, TIGTA will be able to support critical audit, investigative, and inspection and evaluation priorities. The additional funds will enable the Office of Audit to immediately initiate audits that require travel to various IRS locations that had been placed on hold due to budget constraints. In addition, the Office of Audit will be able to immediately initiate audits in critical areas such as international tax compliance and identity theft.

As additional law enforcement staff is hired, the Office of Investigations will be able to conduct more proactive initiatives to uncover fraud in IRS operations and identify threats to IRS employees and infrastructure. In addition, the Office of Investigations will be able to investigate more complaints of IRS employee misconduct, fraud, waste, and abuse.

### ***Meetings***

**The Commissioner testified that TIGTA is a valuable partner to the IRS. IG's don't create problems, but help uncover them. Nonetheless, employees are usually reluctant to report problems to TIGTA.**

**Question: How often do you meet with the Secretary or the Commissioner?**

I meet with the Treasury Secretary, along with other senior Treasury Bureau officials, generally on a monthly basis. In addition, the senior TIGTA executive team and I generally meet with the IRS Commissioner on a monthly basis.

**Question: Do they listen to your concerns? Do they share their concerns with you?**

Yes. During the monthly meeting with the Treasury Secretary, all participants have the ability to share concerns related to various issues impacting the Federal Government and Department of the Treasury operations. TIGTA executive management and I provide the IRS Commissioner with the status of significant audits and investigative work and share concerns on key issues impacting tax administration during the monthly meetings.

**Question: If the Commissioner and the Secretary are not sharing their concerns with you, can IRS employees be expected to share their concerns with you?**

TIGTA uses various methods to inform IRS employees, as well as tax practitioners and the public, of how to share concerns with TIGTA related to tax administration. Specifically, TIGTA's Office of Audit and Office of Investigations provide periodic presentations to IRS personnel to provide them an overview of TIGTA and the role of the audit and investigative programs. These presentations also provide examples of integrity and internal control issues and how IRS employees can report these types of concerns to TIGTA. TIGTA also provides similar presentations to other external audiences, such as tax practitioners at their annual meetings and at the IRS's annual tax forums.

TIGTA's toll-free hotline number is used by individuals to confidentially or anonymously report allegations of violations that impact the integrity of Federal tax administration and IRS programs. IRS employees share their concerns with TIGTA by contacting our Hotline or by contacting an Office of Investigations field office directly. Over the past three years, IRS employees made 19,463 complaints to TIGTA (929 complaints to the Hotline and 18,534 complaints to a field office). Furthermore, IRS employees are given an opportunity to share their concerns with TIGTA special agents during integrity awareness presentations given by my staff to IRS employees each year, and at site visits and other meetings my staff conducts with IRS employees throughout the year.

**Financial Services and General Government Subcommittee**  
**Hearing on Internal Revenue Service Oversight**  
**for the United States Taxpayer Advocate**  
**Nina E. Olson**

**Questions for the Record Submitted by Chairman Ander Crenshaw**

*Meetings*

The Commissioner testified that Taxpayer Advocate Service (TAS) is a valuable partner to the IRS. Nonetheless, IRS employees demonstrate a reluctance to report problems to TAS.

**Question:** How often do you meet with the Secretary or the Commissioner?

**Response:** I generally meet with the Commissioner several times a month. I meet with him individually whenever I have issues that I believe warrant his attention, and I meet with him quarterly to review the performance and priorities of TAS. The National Taxpayer Advocate is also included as part of the IRS's Senior Leadership Team, so I participate in regular meetings that he chairs.

I have not met with the current Secretary, but I have met with previous Secretaries of the Treasury. I brief Treasury's Office of Tax Policy on my reports and work with its staff as issues arise that affect taxpayer rights.

**Question:** Do they listen to your concerns? Do they share their concerns with you?

**Response:** I have served as the National Taxpayer Advocate for thirteen years, and the level of communication I have had with the Commissioner and the Treasury Department has varied based on the individuals and the priorities of the agency. Commissioner Koskinen has only been at the agency for three months at this point, but to date, I am pleased that he has been extremely open to hearing the concerns of the National Taxpayer Advocate and TAS, and takes them seriously.

**Question:** If the Commissioner and the Secretary are not sharing their concerns with you, can IRS employees be expected to share their concerns with you?

**Response:** I agree with the thrust of this question – that the organizational view of the Taxpayer Advocate Service is set by the senior leadership. Because TAS's role – and my role as the National Taxpayer Advocate – is to raise concerns when we believe the IRS is not dealing fairly with taxpayers or is not respecting taxpayer rights, there is a certain degree of inherent institutional friction. If the Commissioner emphasizes that TAS and the protection of taxpayer rights are central to the IRS's mission, employees will work collaboratively with TAS. If the

Commissioner views TAS or taxpayer rights as an impediment to efficient IRS operations, employees will be much less likely to understand these rights or work with TAS.

I will say that many IRS employees have an appreciation for TAS's role and work with us regularly. In addition, some employees report systemic IRS problems on our online Systemic Advocacy Management System (SAMS) or to our employees directly. Generally, however, your question accurately reflects that the Commissioner sets the tone.

### ***Video Conferencing***

**Question:** How receptive are taxpayers to seeking assistance from TAS using video conferencing?

**Response:** TAS piloted what we call "Virtual Service Delivery" (VSD) in December 2011. We conducted an employee focus group seven months later to obtain employee impressions of taxpayers' experiences with the program. Employees reported that taxpayers were generally pleased with VSD, saying that the ability of the taxpayer and case advocate to see each other made both of them feel more comfortable and helped facilitate better communication.

During the pilot, TAS also initiated a survey to measure taxpayer satisfaction with VSD directly. The survey was intended to measure customer satisfaction during the initial video conferencing pilot period. However, we did not receive OMB approval to conduct the survey until we were nearly six months into the pilot, so we were only able to survey participants during a limited time and our surveyed population was only half of what we expected. Still, all respondents stated that they agreed or strongly agreed the technology was easy to use and would recommend it to others, and that they were satisfied or very satisfied with the overall experience.

TAS subsequently began using the system in other locations, and taxpayer reactions continued to be positive. Customer comments have been particularly positive for our location in rural Alaska. Because of the size of the state and the difficulty of travel in winter months, the customers who have used VSD appreciated the ability to have a face-to-face experience without having to travel to Anchorage. One customer commented that he "could not afford to miss a day of work or the cost of fuel to travel to Anchorage" and was happy to be able to interact with a TAS employee in the virtual environment.

**Question:** Please provide a summary about the cost and usage of this service.

**Response:** I envision VSD as requiring a multi-year deployment to achieve broad taxpayer participation and achieve cost effectiveness. We are not there yet.

During fiscal year 2013, TAS virtually opened 118 new cases – just under 10 new cases per month.

TAS has eight taxpayer-facing VSD sites, each connected to a support site in a TAS office.<sup>1</sup> The total (one-time) site cost for the 16 end units was just under \$250,000, and the annual recurring cost is just under \$200,000 (including maintenance and Help Desk support).

Over the next few years, we plan to do more to make taxpayers aware of the VSD option where it is available in order to assist more taxpayers, improve the cost effectiveness of the program, and refine it for broader IRS use. Since we receive a significant number of cases from the eight cities with VSD sites and taxpayers who have used VSD have generally been satisfied with it, we believe more taxpayer outreach will prompt more taxpayers to use VSD.

Over the longer term, I believe VSD can be useful in at least two other ways. First, the IRS would be able to offer VSD in locations where there are significant numbers of taxpayers but not enough to warrant a physical office (*e.g.*, Native American reservations). To do this in a cost effective way, the IRS could work with the U.S. Postal Service or other federal agencies that may have an extra room in buildings the U.S. government is already leasing, or with state or local agencies willing to share space for the benefit of their constituents.

Second, I believe we can get to a point in next few years where taxpayers can hold virtual meetings with IRS auditors or collection employees if they have a camera attached to their desktop or laptop. This type of communication with taxpayers via computer should be less expensive than the current VSD program because the IRS would not need to rent space or technology for the taxpayer. However, I believe VSD communication should be refined while the number of participants remains low to ensure it is ready for wider use before we expand the system.

### ***Taxpayer Advocacy Panel***

The Taxpayer Advocacy Panel (TAP) listens to taxpayers, identify taxpayers' issues, and make suggestions for improving IRS service and customer satisfaction.

**Question:** Is TAP conducting outreach to solicit suggestions or ideas from citizens to improve the products and services of the IRS Tax Exempt and Government Entities Division?

**Response:** No. According to its charter, the TAP "shall focus primarily on issues that fall within the jurisdiction of the Wage & Investment and Small Business/Self-Employed operating divisions" in providing a taxpayer perspective to the IRS on improving customer service. In other words, the TAP focuses on the needs of individual taxpayers and small business taxpayers. The TAP occasionally receives taxpayer comments and suggestions on matters outside its

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<sup>1</sup> TAS has taxpayer-facing VSD sites in eight locations: Kenai, AK; San Diego, CA; Tampa, FL; Davenport, IA; Billings, MT; Reno, NV; El Paso, TX; and Spokane, WA.

purview. When that happens, the TAP staff forwards those submissions to TAS's systemic advocacy function for review and action, as appropriate.

However, there is another federal advisory committee that provides input on the products and services of the IRS's Tax Exempt and Government Entities Division. That advisory committee – the Advisory Committee on Tax Exempt and Government Entities (ACT) – was established to provide comments on employee plans, exempt organizations, tax-exempt bonds, and federal, state, local and Indian tribal government issues. The ACT offers stakeholder observations about current or proposed IRS policies, programs and procedures and recommends improvements through a yearly final report.





MONDAY, APRIL 7, 2014.

## INTERNAL REVENUE SERVICE

### WITNESS

**HON. JOHN KOSKINEN, COMMISSIONER**

Mr. CRENSHAW. Good afternoon, everyone. This hearing will come to order.

I want to thank everyone for being here today. This is our second IRS hearing of the year. Our hearing in February focused on the IRS operations, whereas today our hearing will focus on the IRS 2015 budget request.

So welcome back, Commissioner. We appreciate your willingness to come see us again.

Similar to the IRS 2012, 2013 and 2014 budget requests, the Administration is seeking discretionary spending for the IRS well above the discretionary caps that are in current law.

So absent a change in either the Budget Control Act or the Ryan-Murray agreement, \$480 million of the IRS request is both meaningless and pointless because, if the \$480 million was of importance to the Administration, then the President would have found a way to pay for it from the \$1.014 trillion allowable under the Ryan-Murray rather than use a gimmick that the Budget Committees have rejected now for four consecutive years.

Perhaps even more troubling, the Service is asking this Committee for language to pay IRS employees bigger salaries and bigger bonuses than are allowed under the civil service system and, also, to eliminate some language that we put in the Omnibus Bill last year.

Specifically, the language that we put in to prohibit the IRS from targeting groups from additional scrutiny based on their ideological beliefs is not in the Administration's budget request.

We put in language to prohibit the IRS from targeting citizens of the United States for exercising their rights guaranteed under the First Amendment, and that language has been eliminated, too.

We also had language that would prohibit the IRS from producing videos without being reviewed for cost, topic, tone and purpose, and that has been eliminated as well.

So on its face, Mr. Commissioner, your request appears to ask for a \$1 billion increase in order for the IRS to silence the Administration's critics and to make silly videos. I am sure that is not your intent.

But I would like to hear why you propose to eliminate these good government provisions, which were intended to help restore credibility and confidence to the IRS.

And as you can tell from the roughly, I guess, 150,000 comments on the draft 501(c)(4) regulation, Americans are still angry about the additional scrutiny that the IRS gave to certain organizations.

Explaining how the inappropriate criteria came in to use, how they were allowed to go on for years, and who was responsible for them is what is needed to assure the public that the IRS can administer the Tax Code in an impartial and nonpartisan manner.

Requesting a \$1 billion increase, eliminating prohibitions against targeting that were negotiated by this Committee, and proposing a new rule for the 501(c)(4) before investigations by Congress and the Department of Justice have been completed will not build trust in the IRS, the Department of the Treasury or the Federal Government in general.

So now let me turn to Ranking Member Serrano.

And, again, Commissioner, we thank you for being here today.

Mr. Serrano.

Mr. SERRANO. Thank you, Mr. Chairman.

I would also like to welcome our Internal Revenue Service Commissioner back to the subcommittee. It has been a whole 5 weeks since we last saw you. So welcome back.

We are here today to discuss your fiscal year 2015 budget request in which you request significant new resources in order to better do the job that we in Congress have given you.

But before we do that, I think it is important to have some historical context. In fiscal year 2010, the IRS was funded \$12.146 billion. In fiscal year 2011, the first year the other side was in charge of the House, that number dropped \$25 million to \$12.121 billion. Fiscal year 2012, that number was reduced even further to \$11.8 billion. And in 2013, because of the sequester, the IRS was forced to operate at a level of \$11.199 billion.

Last year we were able to restore some funding to the IRS, but the Agency is still funded at levels well below previous years. Since Republicans took over the House, there has been a cut of close to \$1 billion in funding.

I am sure some of my colleagues think that cutting funding for the IRS is a good thing, and I am sure some of them are proud of this effort. But I am not sure we want the tax laws with no one able to answer questions when our constituents have them and with no one around to ensure justice for those who attempt to evade the law.

And today I am sure we will hear complaints about the reduction in the level of service or the reduction in the ability of our taxpayer service centers to accept tax applications.

Well, we need to be clear as to the reason why. We can talk about conference waste all we want to. But when you cut almost \$1 billion in funding, then people should not be surprised when the IRS cannot do all that we ask of them.

No one here debates that ensuring efficiency in any government agency is important. But, at a certain point, the level of cuts overwhelms the ability of an agency to streamline their operations, which is why your budget request is so important.

Your request seeks to restore significant funding to the Agency both to help rebuild needed services and to help enforce some of the most abused areas of our Tax Code.

You are asking for money to prevent identity theft and to address the backlog of cases where we know money is owed to the government. You ask for resources to implement the tax provisions of the Affordable Care Act and to expand audit coverage.

In my mind, these all seem like important and worthy investments in the Agency that brings in the vast majority of our Nation's revenue.

I know the IRS is an easy Agency to beat up on, especially after last year's controversies, but it seems to me that it is much more responsible to ensure that we are adequately funding the Agency rather than hindering its ability to function properly.

Mr. Chairman, since you brought it up—I had not intended to bring it up—I think that the recent report that came out about the alleged abuses, the timing was excellent. It came right before this hearing, and maybe there was a reason for that.

Secondly, I am on record here three, four, five, maybe even more, times saying that, if, indeed, abuses were committed against organizations or any groups, that I am as outraged and upset and lack tolerance of it as much as any Republican or any American.

But at the same time, we seem to know, we are pretty sure, that different groups were targeted. And why we continue to argue that only conservative or Tea Party groups were targeted only makes this hearing and these kinds of conversations much more difficult.

So I would hope that, as time goes on, people will stop politicizing this issue and get to the facts, number one, and number two, get to the point where we understand that the IRS is charged with a special responsibility, they must meet that obligation, and we must be supportive of it.

Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you.

And I see that we have been joined by the Ranking Member of the full Committee, Mrs. Lowey. So I would like to recognize her for any opening statements she might like to make.

Mrs. LOWEY. Well, I certainly would like to thank Chairman Crenshaw, Ranking Member Serrano for holding this hearing.

And I would like to thank Commissioner Koskinen, a distinguished graduate of Duke University, for coming before the Committee this afternoon.

As we know, the IRS fiscal year 2015 budget request calls for \$12.477 billion in funding, an increase of 10.5 percent above the fiscal year 2014 enacted level. This includes \$2.317 billion for taxpayer services, \$639.25 million for prefilling taxpayer assistance and education. In addition, the request includes \$5.134 billion in enforcement initiatives.

As we know, funding for enforcement not only holds tax frauds accountable, it also brings in more than a 5-to-1 return on investment.

I am concerned that the Republican majority's efforts to continually underfund the IRS makes it easier for tax cheats to go undetected and more difficult for law-abiding members of the public to get questions answered and the resources they need from the IRS.

And I want to also thank you because I know you have been traveling around the country visiting various offices, talking to employees and trying to get as much information as you can so you

could certainly do the job appropriately and continue your distinguished career.

As we saw last year with the reports of inappropriate screening criteria, funds for proper training and taxpayer services are severely needed so that employees know proper procedures and, most important, American taxpayers can have confidence in the IRS.

Commissioner Koskinen, to put it simply, you have a lot on your plate. In addition to the budget and Affordable Care Act implementation, this year for the first time gay and lesbian married taxpayers will be able to file jointly as well as amend past tax returns, as some States such as New York recognize same-sex marriage and some, unfortunately, do not, leading to more confusion for taxpayers who look to the IRS for guidance.

I look forward to discussing some of these matters in more detail with you shortly. And thank you again for your service.

Mr. CRENSHAW. Thank you very much.

Now we will have some time for some questions. Oh, I almost forgot to call on the Commissioner for his opening statement.

So, if you could, limit your remarks to about 5 minutes. You can certainly submit your written statement for the record. And I apologize for almost not recognizing you.

Please be recognized. And we would love to hear what you have to say. Thank you.

Mr. KOSKINEN. Chairman Crenshaw, Ranking Member Serrano, Congressman Lowey, Congressman Womack, thank all of you for the opportunity to provide you with an overview of our proposed Fiscal Year 2015 budget and what we hope to accomplish with those resources.

In discussing the IRS budget, we remain concerned about the constraints under which the IRS has been operating since 2010. Our funding for Fiscal Year 2014 was set, as noted, at \$11.29 billion, more than \$850 million below the rate for Fiscal Year 2010.

It is important to note the IRS is the only major Federal Agency operating at close to our post-sequester level rather than returning to the higher, pre-sequester level, as many other agencies were allowed to do.

The ongoing funding shortfall has major implications for taxpayers and the tax system. This year, millions of taxpayers are finding unacceptably long wait times on the phone and at our Taxpayer Assistance centers to get basic questions answered and to resolve tax issues.

Further, as a result of fewer staff and reduced enforcement activities, the IRS estimates it will not be able to collect billions of dollars in enforcement revenues.

We estimate this year we would have returned to the Federal Government over \$2 billion more in collections had we received the remaining \$500 million cut from our budget by the sequester.

The solution of the funding problem faced by the IRS begins with the administration's Fiscal Year 2015 budget request, which totals \$12.64 billion. That is approximately \$1.35 billion above the fiscal year 2014 enacted level.

American taxpayers deserve to know what value they would receive for the \$1.35 billion increase in funding requested for the IRS. Let me give you a few details.

About \$400 million would go to taxpayer service programs. We estimate this would allow us to answer an additional 12 million taxpayer calls and cause our level of phone service to exceed 80 percent, which would be 20 points higher than last year's level of 60.5 percent.

The additional calls answered would include calls from those seeking help with the tax-exempt provisions of the Affordable Care Act.

We would also improve phone service by, for example, making our system capable of retaining taxpayers' identifying information so they wouldn't have to repeat it after being transferred from one operator to another.

Part of the funding would also go to technology investments for such things as further improvements to our Web site at [irs.gov](http://irs.gov).

Another \$334 million of the total additional request would go to enforcement programs. With this funding, we estimate closing more than 500,000 additional cases, including individual audits, employment tax exams and collection activities.

We would also be able to do other things, like increase our document matching program which we use to spot underreporting of income.

Through these activities, we estimate we would collect an additional \$2.1 billion a year in enforcement revenues. That would more than pay for the entire amount of additional funding being requested for the IRS for fiscal year 2015.

An important subset of enforcement is the fight against refund fraud caused by identity theft. About \$65 million of the additional request would go to this area.

We estimate that, through improved identity theft fraud detection, we would protect an additional \$360 million a year in revenue from going out the door. We would also close an additional 13,000 cases where taxpayers have been victimized by identity thieves.

Another major priority for us is implementing enacted legislation. We would use \$394 million of the additional request to continue implementing the Affordable Care Act and FATCA.

A large portion of this is for IT upgrades. For example, we need to build new technology systems to process and analyze the reports coming to us from financial institutions under FATCA.

Investments in IT are also needed to continue implementing two major ACA provisions, the Premium Tax Credit and the Individual Shared Responsibility provision. I want to stress that we are mandated to implement ACA and FATCA; so, if we don't receive this funding, we must take it from either taxpayer service or enforcement or both.

With respect to information technology, we would use another \$100 million of additional requests to invest in a number of longer-term IT projects on the drawing board that are designed for such things as providing a more stable and secure computing environment and taking us to the next level of digital services for taxpayers.

I want to emphasize that we take very seriously the need to be careful stewards of the funding we receive. Congress and the American public need to be confident that this money will be used wisely.

It is my responsibility to ensure that happens, and I would be delighted to report back to the Committee as Fiscal Year 2015 unfolds to discuss with you what the American taxpayer, in fact, receive for any additional investments in our Agency.

That concludes my statement. And I would be happy to take your questions.

Mr.CRENSHAW. Thank you very much.

[The information follows:]

**WRITTEN TESTIMONY OF  
JOHN A. KOSKINEN  
COMMISSIONER  
INTERNAL REVENUE SERVICE  
BEFORE THE  
HOUSE APPROPRIATIONS COMMITTEE  
SUBCOMMITTEE ON FINANCIAL SERVICES AND GENERAL GOVERNMENT  
ON THE FY 2015 IRS BUDGET  
APRIL 7, 2014**

**I. INTRODUCTION**

Chairman Crenshaw, Ranking Member Serrano and Members of the Subcommittee, thank you for the opportunity to appear before you today to update you on the IRS' performance under our current funding levels for Fiscal Year (FY) 2014 and to provide you with an overview of our FY 2015 Budget and what we hope to accomplish with those resources.

The IRS is vital to the functioning of government and to keeping our nation and economy strong. We support the nation's tax system by providing taxpayer service to help people understand and meet their tax responsibilities while ensuring enforcement of the tax laws. The agency plays a unique role in government, and resources invested in the agency lead to significant revenue increases for the nation.

In FY 2013, the IRS collected \$2.9 trillion in gross revenue to fund the federal government, approximately 91 percent of all federal receipts. Moreover, for FY 2013, we processed more than 147.6 million individual income tax returns and issued more than 118 million refunds to individual taxpayers totaling nearly \$314 billion. This is a tremendous accomplishment, especially given that processing such a high volume of returns is an annual occurrence for this agency. It is important to remember that this does not happen automatically or by accident, but occurs as a result of the efforts of our highly experienced and capable workforce.

The IRS has made major progress since FY 2010 in finding hundreds of millions of dollars in cost savings and efficiencies. However, even with these savings, the FY 2014 IRS budget approved by Congress continued a funding shortfall for the agency that has major implications for taxpayers and the tax system, both for this year's tax season and beyond. It is important to note that the IRS continues to operate at near sequestration levels, with the agency's FY 2014 funding less than one percentage point above FY 2013 levels. Our current level of funding is

clearly less than what the agency needs, especially to provide the level of taxpayer services the public has a right to expect.

This year, millions of taxpayers continue to see longer wait times on the phone to get basic questions answered and resolve tax issues, though IRS employees are working diligently to reduce those wait times as much as possible. Further, as a result of fewer staff and reduced enforcement activities, the IRS estimates it will not be able to collect billions of dollars in enforcement revenues. The IRS is committed to carrying out its core responsibilities and working to preserve the public's faith in the essential fairness and integrity of our tax system, yet continued funding reductions will pose serious challenges to these efforts.

The IRS remains committed to being as efficient as possible and spending taxpayer dollars wisely, and we will continue to find savings wherever we can. At the same time, the FY 2015 President's Budget will allow us to invest in strategic priorities so that we can continue to fulfill our dual mission of strong enforcement of the tax laws and excellent customer service.

To summarize, the Budget funds the following activities and programs: improving service to taxpayers; increasing our efforts against refund fraud, especially fraud caused by identity theft; making our compliance efforts more strategic, using new tools, data and capabilities to conduct a balanced enforcement program; and investing in advanced technology to enhance both service and enforcement activities. The IRS will also continue to implement and administer tax-related provisions of major legislation, including the Foreign Account Tax Compliance Act (FATCA) and the Affordable Care Act (ACA).

In discussing our budget situation, we recognize that there has been a loss of confidence among taxpayers and particularly within Congress in regard to the way we manage operations, particularly the management problems that came to light last year in the section 501(c)(4) area. One of my responsibilities is to ensure that we are minimizing risks and quickly solving management and operational problems that may arise, so that Congress can be confident that when we request additional funding the money will be used wisely. Taxpayers provide the funds we receive and they deserve to be confident that we are careful stewards of those resources.

Despite the limits on our resources, I remain impressed with the professionalism and commitment of our workforce. Our employees have continued, throughout these challenging times, to perform critical work for the IRS and the nation – helping people understand and meet their tax responsibilities while ensuring enforcement of the tax laws. They are making every effort to ensure a smooth experience for taxpayers despite the funding shortfall.

## **II. IRS PERFORMANCE: FY 2013 AND CURRENT FILING SEASON**



Through both taxpayer service and enforcement programs, the IRS remains committed to making the tax laws easier to access and understand and to improving voluntary compliance and reducing the tax gap – the difference between taxes owed and taxes paid on time. Taxpayer service supports and protects the trillions of dollars in revenue that come into the Treasury each year voluntarily from taxpayers by helping them understand their obligations under the tax law. Enforcement pursues those who evade or misrepresent their tax responsibility.

### **Filing Season**

One of the most important activities the IRS undertakes each year is delivering a smooth and successful filing season. The IRS delivered another successful tax filing season in 2013, rising to the challenges posed by tax legislation enacted on January 2 of that year. The filing season began on January 30, 2013, less than one month after the passage of legislation that affected more than 600 tax products needed for the filing season. The IRS took the necessary steps to minimize disruptions for taxpayers, including working around the clock to update our forms and computer systems.

As noted, during 2013, the IRS processed more than 147.6 million individual income tax returns and issued 118.7 million refunds totaling almost \$314 billion. In addition, IRS employees responded accurately to 95.7 percent of tax law questions and 96.0 percent of taxpayer account questions. Largely as a result of the ongoing decline in agency funding and the late tax law changes, for FY 2013, the telephone level of service for taxpayers trying to reach the IRS' toll-free lines dropped to 60.5 percent, the lowest level since FY 2008. That means that approximately 40 percent of taxpayers who called were unable to reach an IRS employee.

The current filing season, which began on January 31, started strongly and continues to go well. Through March 28, 2014, the IRS has received more than 90.7 million individual income tax returns and issued more than 73 million refunds for approximately \$206.8 billion.

Our level of phone service has appeared to improve thus far this filing season. We have been able to maintain a level of phone service of around 72 percent for the filing season so far, meaning that nearly three quarters of taxpayers who called this filing season got through to the IRS. One reason may be that the volume of calls to our toll-free lines is actually down somewhat. We believe that is largely because there were no significant tax law changes enacted in 2013 and because tax return processing has gone relatively smoothly. In addition, we continue to provide more resources to taxpayers on our website, which we believe offers an alternative to the phone. However, increases in volume will negatively impact these results, and we expect that for the year we will drop

below 70 percent and end up closer to last year's 60.5 percent. We will continue to monitor telephone service levels and work to maintain as high a level of phone service as possible within our resource limitations.

An area of concern this year is the amount of time people have to wait to get in-person help at our Taxpayer Assistance Centers (TACs). We have had reports from field staff of taxpayers lining up outside TACs well before the centers open in the morning to make sure they receive service the same day. We also have reports of people waiting 90 minutes or more to be helped once they have arrived inside the TAC and taken a number for service. Unfortunately, given our resource limitations we have few options to drive down these wait times.

### **Taxpayer Service**

Providing taxpayers with top-quality service and helping them understand and meet their tax obligations remained top priorities for the IRS in FY 2013. During FY 2013, the IRS updated forms to help taxpayers comply with filing requirements, converted forms for visually impaired taxpayers, and translated more tax products into multiple languages. In addition, the IRS continued its effort to redesign taxpayer correspondence in plain language and in a consistent format to make it easier for taxpayers to understand their obligations.

The IRS continued to provide alternative service options in FY 2013 by increasing the amount of tax information and services available on IRS.gov. In FY 2013, taxpayers viewed IRS.gov web pages more than 1.87 billion times as they used the website and mobile applications to obtain forms and publications, get answers to tax law questions, and check the status of their refunds.

Taxpayers used the "Where's My Refund?" online tool in 2013 nearly 201 million times to check refund status, an increase of 51.6 percent from 2012. Last year, the IRS enhanced the "Where's My Refund?" tool to allow taxpayers to find out when their tax return was received, when the refund was approved, and when the refund was sent.

The IRS also deployed a new telephone and web tool called "Where's My Amended Return?" in both English and Spanish that allows taxpayers to check the status of their Form 1040X amended tax returns for the current year and up to three prior years. The tool also provides taxpayers with other information, such as when their amended return was received, adjusted, and completed, as well as specific information regarding offset conditions, such as a previous IRS tax liability or a past due obligation.

The IRS continues to improve and expand on its outreach and educational services through partnerships with State taxing authorities, volunteer groups, and other organizations. Volunteer Income Tax Assistance (VITA) and Tax

Counseling for the Elderly (TCE) sites provide free tax assistance for low-income individuals, the elderly and disabled, and individuals with limited proficiency in English. In FY 2013, more than 91,800 volunteers prepared 3.4 million federal returns, 95.3 percent of which were filed electronically, and more than 2.5 million state returns. The IRS also teamed up with its national partners to offer a remote filing method – Facilitated Self-Assistance (FSA) – at VITA sites. More than 82,000 FSA returns were filed at the 330 VITA sites offering the FSA remote filing model.

I am pleased to report that the IRS' technology efforts in relation to improving taxpayer service recently received public recognition. Last month, the Excellence.gov Awards Program sponsored by the American Council for Technology and the Industry Advisory Council recognized the IRS' Virtual Service Delivery (VSD) program for Excellence in Customer Experience. VSD technology units allow face-to-face contact between IRS employees and taxpayers at remote sites through two-way video conferencing. These units help the IRS resolve taxpayer issues remotely at understaffed and unstaffed Taxpayer Assistance Centers, Taxpayer Advocate Service sites, and Low Income Taxpayer Clinic locations.

With the IRS budget now in its fourth year of relative decline, significant effects on taxpayer services will become more apparent in FY 2014. The IRS has 11,000 fewer people working during the 2014 filing season than it had in 2010 while processing the largest number of tax returns in the agency's history.

In addition to our concerns about the overall level of phone service noted above, we estimate that taxpayers may see average wait times of 25 minutes per call, compared with 10 minutes in 2010. Given current resources, we also expect that it will take longer for us to respond to taxpayer correspondence. Historically, 70 percent of letters we receive have been answered within 30 days, but we expect that more than half of all correspondence this year will take more than 45 days to answer.

As Forbes magazine recently noted, a reduction in IRS funding that erodes service levels "punishes" taxpayers.

### **Tax Compliance**

In FY 2013, as a result of the impacts of sequestration and furloughs, the IRS delivered key enforcement programs well below historical levels. Total individual audits fell 5 percent from 1.48 million in 2012 to 1.40 million, while audits of high-income individuals declined from 179,000 to 172,000. This translated to an individual coverage rate below 0.9 percent, an historical low. Likewise, business return audits dropped 13 percent from 70,000 to 61,000.

Enforcement totaled \$53.3 billion in FY 2013, an increase of \$3.1 billion over FY 2012. This was the fourth consecutive year the IRS exceeded \$50 billion, for a total IRS-wide return on investment (ROI) of \$4.8 to \$1. Most of the increase came from a \$2.6 billion rise in revenue from our Appeals function which, due to the timing of the Appeals process, generally relates to examinations occurring in previous years. Revenue from the Collection function, the levels of which also frequently rise and fall in tandem with the overall health of the economy, increased by nearly \$1 billion in FY 2013.

While the overall receipts from enforcement increased in 2013 compared to the prior year, the total is still down by more than \$4.3 billion from four years ago. The reason for this decline is primarily due to a decline in revenue from audits, which dropped nearly \$400 million in FY 2013 to \$9.83 billion, the lowest level in a decade. This decline in audit revenue is attributable to a decline in the number of returns audited.

We are concerned the decline in core enforcement activities during FY 2013 that was noted above is expected to continue in FY 2014, given the ongoing challenging budget environment. For example, we expect audits to decline by an estimated 100,000 from FY 2013 and the number of collection activities to decline by an estimated 190,000.

Despite the circumstances, the IRS has made significant progress in a number of major enforcement areas. One of these was international compliance. Strategic enforcement efforts and the parallel Offshore Voluntary Disclosure Program (OVDP) give U.S. taxpayers with undisclosed offshore assets or income an opportunity to become compliant with the U.S. tax system and avoid potential criminal charges. The OVDP has resulted in more than 43,000 disclosures and the collection of about \$6.5 billion in back taxes, interest, and penalties since the program was first established in 2009.

The IRS also continued to focus on service and compliance activities in regard to tax return preparers. Return preparers play a key role in increasing taxpayer compliance and strengthening the integrity of the U.S. tax system. The IRS requires anyone who prepares or assists in preparing federal tax returns for compensation to have a valid Preparer Tax Identification Number (PTIN). PTINs allow the IRS to collect more accurate data on who is preparing returns, the volume and types of returns being prepared and the qualifications of those doing return preparation. Additionally, PTIN data is essential in determining where to direct compliance and educational outreach efforts for erroneously prepared tax returns. The IRS recently held a successful PTIN renewal season, offering enhanced PTIN system usability, troubleshooting tips, and other tools. As of March 2014, the number of valid PTINs totaled approximately 677,000.

In FY 2013, the IRS continued to educate and inform return preparers on tax law compliance in a number of ways, including: making visits to more than 3,000

return preparers around the country, including 300 compliance visits to preparers who handled large numbers of returns claiming the Earned Income Tax Credit (EITC); and addressing preparers who were found to have made egregious errors through education and outreach and through a variety of methods to ensure appropriate penalties and/or sanctions were imposed.

A critical area of focus involves stopping erroneous claims for refundable tax credits, particularly the EITC. We are concerned that the improper payment rate has remained unacceptably high throughout the program's history. Therefore, we initiated a major review of our activities in this area earlier this year. If Congress enacts the proposal in the Administration's FY 2015 Budget to provide the IRS with greater flexibility to address "correctible errors," we will have additional tools to stop erroneous claims and, as a result, we believe we will be able to make a real reduction in the improper payment rate.

The IRS criminal investigation program examines potential criminal violations of the Internal Revenue Code and related financial crimes such as money laundering and tax-related identity theft fraud. In FY 2013, the IRS completed 5,557 investigations; achieved a conviction rate of 93.1 percent; maintained a Department of Justice case acceptance rate of 95.5 percent, which compares favorably with other Federal law enforcement agencies; and obtained 3,311 convictions.

Refund fraud related to identity theft continues to be a major focus for us and touches nearly every part of the IRS. In FY 2013, the IRS continued to focus on a comprehensive and aggressive strategy to identify and combat tax-related identity theft. Last year, the IRS conducted a number of activities in this area. These included: issuing Identity Protection Personal Identification Numbers (IP PINs) to more than 770,000 taxpayers for the 2013 filing season; conducting 191 identity theft outreach events with tax and accounting practitioners, the general public, and the media; and working with victims to resolve and close more than 963,000 identity theft cases.

### **Business Systems Modernization**

IRS modernization efforts during FY 2013 continued to focus on building and deploying advanced information technology (IT) systems, processes, and tools to improve efficiency and productivity. FY 2013 modernization successes included the following:

- The IRS' Customer Account Data Engine 2 (CADE 2) posted more than 139 million returns and issued more than 111 million refunds totaling \$281 billion during the filing season. Daily processing and posting of individual taxpayer accounts – which improved on the prior system of weekly processing and posting – enabled faster refunds for millions of taxpayers.

- Modernized e-File (MeF) Release 8 deployed for the filing season and was the sole e-file platform used as the IRS processed 224.7 million individual returns, and 16.8 million Business Master File returns.
- The IRS launched the Information Return Document Matching program and began selecting casework in January 2013. This program matches new information returns, such as Form 1099-K, Payment Card and Third Party Network Transactions, with both individual and business tax returns to identify potential income underreporting or non-reporting.
- The IRS launched a new web portal that improved taxpayer access to IRS.gov. The Integrated Enterprise Portal accommodated a 22 percent increase in visits and a 6 percent increase in page views in FY 2013 compared to FY 2012.

Looking ahead, we believe that IRS IT operations in FY 2014 will suffer a significant negative impact from the continuing tight budget environment. We anticipate that FY 2014 funding will not be sufficient to address critical technology infrastructure needs such as: additional improvements to IRS.gov; new identity theft prevention tools; and upgrades to the basic computer software used by our employees that are needed to reduce system vulnerabilities.

### **Implementing Enacted Legislation**

Within its budget constraints, the IRS nonetheless has an obligation to carry out the legislative responsibilities Congress has approved over the last several years, particularly ACA and FATCA. Implementation activities involving both statutes carried out in FY 2013 will evolve and continue through FY 2014 and into FY 2015.

With regard to ACA implementation, I am pleased to be able to tell you that the systems and processes that the IRS developed to support enrollment in the new Health Insurance Marketplace were launched on schedule and are working as planned. We continue to focus on two significant provisions that go into effect in 2014: the premium tax credit and the individual shared responsibility provision. These two provisions will have a profound impact on IRS forms and procedures beginning with the 2015 filing season, and will require additional taxpayer services and education activities.

Preparation is already well underway to modify forms and instructions, enhance education and outreach to taxpayers and their advisors, and update our systems and processes in time for the 2015 filing season. The IRS is also focusing on ensuring that returns that erroneously or fraudulently claim refundable premium tax credits (or fail to reconcile advance payments of the credit) are efficiently identified and addressed using Marketplace information available during the filing season as well as the ever-improving IRS tools used for all returns to address errors and fraud.

Another major initiative is implementation of FATCA, which is an important new tool in our offshore compliance efforts. FATCA requires foreign financial institutions (FFIs) to report information to the IRS about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. Withholding requirements under FATCA go into effect on July 1, 2014. It is important to note that legal restrictions in some countries prevent FFIs from fulfilling the reporting, withholding and account disclosure requirements. For that reason, Treasury, with assistance from the IRS, is advancing an intergovernmental approach to FATCA implementation that is focused on bilateral agreements that address these legal impediments, simplify practical implementation and reduce the costs to FFIs. As of early April, there were 26 signed Intergovernmental Agreements. In addition, there are another 19 jurisdictions where agreement has been reached in substance, bringing the total number to 45.

The IRS FATCA registration website opened in August 2013 to allow financial institutions to begin to enter data. In January 2014, financial institutions were able to begin submitting their electronically signed FATCA agreements. Going forward, one of the IRS' biggest challenges involves having the resources to build and maintain systems that can effectively process all the incoming data. Beyond building these systems, we also will need additional staff to analyze the information and develop compliance programs around the new data.

### **Exempt Organizations**

The IRS is continuing the efforts it began in FY 2013 to implement broad managerial and operational improvements in the determination process for tax-exempt status. In this work we are focusing on applications for recognition of tax-exempt status under both sections 501(c)(3) and 501(c)(4).

We continue to address the issues and concerns surrounding the determinations process for section 501(c)(4) applications. In FY 2013 and continuing into this fiscal year, the IRS has made important progress in responding to the recommendations made by the Treasury Inspector General for Tax Administration (TIGTA) in a May 2013 report describing problems with the processing of these applications. As of the end of January 2014, the IRS completed action on all nine TIGTA recommendations contained in that report.

Our responses to the TIGTA recommendations include the actions we have taken to reduce the inventory of section 501(c)(4) applications, including the group of 145 cases in the "priority backlog" – those that were pending for 120 days or more as of May 2013. As of March 13, 2014, 126 of those cases, or 87 percent, have been closed. Of the closed cases, 98 of them were approved, including 43 organizations that took advantage of a temporary self-certification procedure we offered in summer 2013. Of the remaining 28 closed cases, most were closed either because the organization withdrew the application or it failed

to respond to our questions. To date, three applications have been formally denied. The 19 cases still open generally fall into one of two categories: either the taxpayer has asked for and received additional time to respond to our questions, or the case is being litigated. None of these 19 organizations opted to accept the self-certification procedure used by 43 organizations to obtain prompt approval of their applications.

Also consistent with the response to the TIGTA recommendations, draft proposed regulations were released in November 2013 that are intended to provide clarity in determining the extent to which an organization's political activity is consistent with tax-exempt status as a social welfare organization. I believe it is extremely important to make this area of regulation as clear as possible, not only because it will help guide the IRS in proper enforcement, but because it will also give a better roadmap to applicants and help those that already have section 501(c)(4) status understand the applicable standards and properly administer their organizations.

As Treasury has noted in the past, the central purpose of any Notice of Proposed Rulemaking is to solicit public comments on proposed regulations, and we intend to consider all public comments we have received on these proposed regulations before moving forward in the regulatory process. Indeed, we received more than 150,000 comments on these proposed regulations, which is a record for an IRS rulemaking comment period. In addition, while I do not control the regulatory process, I am committed that any final regulation should be fair to everyone, understandable and easy to administer. It is also important that every taxpayer be confident that, whenever they interact with the IRS, they will be treated the same as any other taxpayer, no matter what their beliefs, what organizations they belong to or whom they voted for in the last election. Taxpayer trust in the integrity of the IRS is our most important asset, and my primary goal is to do whatever is necessary to restore whatever trust has been lost as a result of the inappropriate criteria used to scrutinize some 501(c)(4) applications.

Improving the section 501(c)(3) application process has been another significant area of focus for our agency, and we have been working diligently to make the process less burdensome for applicants in a number of ways. We presently have a backlog of 60,000 section 501(c)(3) applications, many of them well over a year old.

Our Exempt Organization (EO) group consistently receives more than 60,000 applications per year, consisting primarily of applications for section 501(c)(3) status. The agency has experienced a substantial rise in applications since 2010, due in large part to automatic revocations of tax-exempt status that occurred under the 2006 Pension Protection Act beginning in 2011, and the subsequent requests for reinstatement, which have added more than 50,000 cases to EO's workload since FY 2010.



We have taken a number of actions to deal with the backlog in 501(c)(3) applications. On January 2, 2014, the IRS issued Revenue Procedure 2014-11, which makes the reinstatement process more efficient for organizations whose status was automatically revoked and allows a majority of revoked organizations to use a streamlined process to apply for retroactive reinstatement of their exempt status.

Looking beyond the issue of automatic revocations, the IRS has recently developed another way of making the determination process more efficient for section 501(c)(3) organizations. The Interactive Form 1023, Application for Recognition of Exemption under Section 501(c)(3), which was made available online in September 2013, should result in more complete applications. This will thus reduce processing time by minimizing the IRS' need to request additional information to make a determination.

We have also taken all applications that were more than a year old as of last fall and devoted the necessary resources to resolving virtually all of them in the next months. We also are working to have no applications still pending at the end of this year that have been filed more than nine months earlier. Ultimately, we want to process all applications within a six-month time frame, with a backlog of less than 30,000 cases at any time.

To make this possible we are also examining the feasibility of creating a streamlined application process for certain organizations seeking tax-exempt status, in particular small organizations that pose a low risk of noncompliance. The goal is to come up with a new procedure this summer that is more efficient without introducing major risks into the system for approving applications. These streamlined applications could be processed in a matter of weeks rather than months.

### **III. THE ADMINISTRATION'S FY 2015 BUDGET REQUEST**

The budgetary constraints under which the IRS has been operating since 2010 continue to pose very serious challenges to our efforts to enforce the tax laws and provide excellent customer service. Our FY 2014 enacted appropriation was \$11.29 billion, which is more than \$850 million below the FY 2010 funding level in nominal dollars, or over a billion in real dollars. This represents a 7 percent cut in our annual budget since 2010 while the total population of individual and business filers grew by more than 4 percent over the same time period.

Essentially, the federal government is losing billions in revenue collection to achieve budget savings of a few hundred million dollars. In general, the IRS estimates that for every \$1 invested in the IRS budget, it produces \$4 in enforcement revenue, which is a \$4-to-\$1 return on investment to the American taxpayer. This year, for example, the IRS estimates it would have returned to the

Federal government over \$2 billion more in collections had we received the remaining \$500 million that our budget was cut as a result of the sequester.

The solution to the funding problems faced by the IRS begins with the President's FY 2015 Budget request, which, with the inclusion of the program integrity cap adjustment and the Opportunity, Growth and Security Initiative totals \$12.64 billion. This is approximately \$1.35 billion above the FY 2014 enacted level of \$11.29 billion. This amount includes a \$480 million program integrity cap adjustment to vitalize tax compliance and a \$165 million additional investment through the Opportunity, Growth and Security Initiative to deliver performance enhancements that taxpayers deserve.

The aim of the President's proposal is twofold. First, it is designed to reverse the erosion in the IRS budget over the last several years. In so doing, it will help taxpayers get the service they expect. It will also strengthen compliance in key areas, such as international tax compliance, high-wealth individuals and flowthrough entities, in large part by halting the recent declines in the number of key enforcement personnel. Longer term, the proposal also positions the IRS well for the future by allowing the agency to invest in necessary basic infrastructure, as well as advanced technology.

The Budget request also provides funding to: implement enacted legislation; enforce return preparer compliance; expand criminal investigation capabilities; address compliance issues in the tax-exempt sector, including employee retirement plans, exempt organizations, and direct-pay bonds; and provide appropriate and balanced coverage by improving examination audit and collection coverage rates.

In regard to compliance, increased resources for IRS enforcement programs yield direct, measurable results through activities that provide a high return on investment. It is important to point out that this request includes a \$480 million program integrity cap adjustment that will reduce the deficit through above-base funding for high-return tax enforcement and compliance programs, of which \$5 million will be transferred to the Alcohol and Tobacco Tax and Trade Bureau. The \$475 million requested for the IRS FY 2015 enforcement initiatives funded through this program integrity cap adjustment is expected to generate nearly \$2.1 billion in additional annual enforcement revenue once the new personnel hired reach full potential in FY 2017. At full performance, these resources requested for enforcement initiatives are expected to generate a return on investment of nearly \$6 to \$1, not including indirect deterrence effects estimated to be at least three times the direct revenue impact. Over the 10-year budget window, the proposal is expected to generate \$52 billion in additional revenue while costing \$17 billion, thereby reducing the deficit by \$35 billion.

It is fair to ask what value the American taxpayer would receive for the increase in funding requested by the President of approximately \$1.2 billion over the FY

2014 enacted level. Let me detail for you how the IRS intends to spend these additional funds in various categories:

**Improve taxpayer service: \$211 million.** This additional funding will allow the IRS to meet the expected increase in demand for taxpayer services in FY 2015. Combined with Opportunity, Growth and Security Initiative resources, the additional funding will allow us to answer about 12 million additional calls from taxpayers seeking our help, including taxpayers seeking assistance in regard to the ACA, and will cause our level of phone service to exceed 80 percent. It also includes \$19 million that will be invested in advanced technology to further expand and improve the services taxpayers receive when they call the IRS. For example, this additional funding will allow the IRS to enhance its automated phone system to let taxpayers elect to be called back instead of waiting on hold, and will allow customer service representatives to call up immediate displays of taxpayer information on their computers, improving response time.

**Prevent refund fraud and identity theft: \$65 million.** This additional funding will allow the IRS to help more taxpayers who have been victims of identity theft resolve their cases. We will also invest in advanced technology to further our efforts in identifying potentially fraudulent returns, allowing us to reduce improper payments. We project that investments in these activities will protect nearly \$1.5 billion in revenue by FY 2017, an ROI of more than \$22 to \$1.

**Address offshore tax evasion: \$57 million.** This additional funding will allow us to expand our efforts to identify and pursue U.S. taxpayers with undisclosed offshore accounts. It will also help the IRS expand criminal investigations of international tax and financial crimes, and expand information gathering to identify those who promote or facilitate abusive offshore schemes. We estimate that this investment will enable the IRS to close an additional 6,600 cases and produce additional, direct annual enforcement revenue of approximately \$293 million once the new hires carrying out these activities reach full potential in FY 2017. That is an ROI of \$4.8 to \$1.

**Expand audit coverage of individuals: \$98 million.** This additional funding will allow the IRS to hire additional personnel to improve our examination efforts in regard to individuals. With these new resources, the IRS will be able to do more exams, match more documents to detect misreported or unreported income, and invest in advanced technology to make our work more efficient by, for example, using barcoding so that some paper documents we receive can be electronically processed. As a result, we estimate that we will be able to close an additional 243,000 individual examination cases. Through these activities, we expect to collect \$674 million more in direct enforcement revenue once the new hires reach full potential in FY 2017, an ROI of \$7.1 to \$1.

**Expand audit coverage of high-wealth taxpayers: \$21 million.** This additional funding will allow the IRS to hire more enforcement personnel to continue our

focus on high-wealth taxpayers. This is a challenging area, as these taxpayers frequently operate complex enterprises containing many interrelated businesses that often have international components. We estimate that, with this investment, we will be able to close an additional 325 cases and produce additional annual enforcement revenue of \$243.9 million once the new hires reach full potential in FY 2017 – an ROI of \$11.3 to \$1.

**Improve audit coverage of partnerships and flow-through entities: \$36 million.** This additional funding will allow the IRS to hire additional staff to keep pace with this segment of taxpayers, the most rapidly growing portion of all tax returns filed. In particular, this will allow us to increase the number of tax examiners with specialized knowledge about partnerships. We estimate that we will be able to close an additional 2,800 cases involving partnerships and produce \$268 million more enforcement revenue annually once the new hires reach full potential in FY 2017, an ROI of \$6.8 to \$1.

**Enhance collection coverage: \$67 million.** This additional funding will allow the IRS to hire new staff to improve our efforts to work with taxpayers to collect back taxes owed. With the additional funding, we will be able to take a more proactive role in reaching out to taxpayers earlier in the collection process. We estimate that this will allow us to close an additional 244,000 collection cases. The funding also will provide additional staff to handle an increasing number of cases involving unpaid employment taxes, which we estimate will allow us to close an additional 45,000 employment tax cases. As a result, we project additional annual, direct enforcement revenue of \$617 million once new hires reach full potential in FY 2017, an ROI of \$8.5 to \$1.

**Improve efforts in the tax-exempt sector: \$16 million.** With this additional funding, the IRS will be able to continue its focused oversight of the tax-exempt sector and improve service to make voluntary compliance easier. We estimate these additional resources will allow us to reach our goal of cutting our backlog of 501(c)(3) applications in half and reducing the processing time for all applications to a period of two weeks or less for smaller organizations and no more than six months for all applications.

**Pursue fraud referrals and tax schemes: \$18 million.** This additional funding will be dedicated to improving our efforts in the core enforcement areas of corporate fraud, employment tax, and abusive tax schemes by increasing the number of convictions and assessments of unpaid tax. A portion of the funding will be for the use of computer software that will allow the IRS to apply so-called network analysis to detect corporate fraud and abuse. With this software tool, the IRS will be able to identify schemes by linking together multiple potentially fraudulent returns or information items. These efforts are expected to help us achieve a conviction rate in this area for FY 2015 of 92 percent.

**Enhance return preparer compliance: \$17 million.** This additional funding will allow the IRS to increase service and compliance activities in regard to tax return preparers. The IRS will be able to increase audits of preparers and increase monitoring and pursuit of preparers engaged in fraudulent activities, including those who prepare large numbers of returns involving EITC claims. We estimate we will be able to conduct 200 additional preparer visits and more than two dozen additional investigations into fraudulent activity.

**Use technology to enhance criminal investigation: \$4 million.** This additional funding will allow the IRS to automate the processing of evidence gathered by our criminal investigators by implementing a virtual digital evidence processing environment. This new system will allow for more secure and efficient evidence processing nationwide, and reduce travel by IRS agents and investigative specialists.

**Use technology to improve audit case selection: \$37 million.** This additional funding will enable the IRS to improve the way we gather and use electronic data, which will in turn allow us to do a better job of selecting cases for audit and focusing on issues that need to be examined. This is important because the IRS needs to continually adapt to changing taxpayer behavior to prevent tax fraud and abuse. Under the initiative we envision, we will significantly increase the digital availability of tax return information and then employ technology to analyze this information in order to better detect noncompliant taxpayer behavior.

**Expand Virtual Service Delivery (VSD): \$8 million.** This additional funding will create a secure, web-based digital communications channel through the Internet using online messaging that ultimately will allow the IRS to communicate directly with taxpayers while they are at work or at home, or using their mobile device. This will improve the taxpayer experience in resolving difficult issues with their accounts.

**Enhance online services: \$16 million.** With this additional funding, the IRS will develop additional digital applications that will further improve taxpayers' online interactions with the IRS. This technology investment will help provide secure digital communications, and add more interactive capabilities to existing web self-service and mobile products.

**Implement ACA: \$452 million.** This additional funding, the majority of which is for required information technology upgrades, will allow the IRS to increase efforts to ensure compliance with a number of tax-related provisions of the ACA, and also perform outreach and educational activities so that taxpayers will understand what these provisions require, as well as covering additional phone calls made by taxpayers inquiring about the ACA. The funding will also assist the IRS in continuing to implement a major ACA provision going into effect in 2014 – the premium tax credit, which will help millions of Americans purchase affordable coverage.

**Implement FATCA: \$32 million.** With this additional funding, the IRS will invest in advanced technology to allow the agency to continue implementing FATCA, which in turn will provide more information to us on offshore accounts of U.S. citizens. As mentioned above, FATCA includes new reporting and withholding requirements for foreign financial institutions. To properly process and analyze the data we receive as a result of these new requirements, the IRS will need to build new technology systems and modify existing systems.

**Enhance information technology services: \$10 million.** This additional funding will enable the IRS to continue upgrading its computer systems, and in particular convert the agency's operating system to a less complex standard, which will decrease our need for computer hardware. These investments will result in a more stable computing environment and reduce delays in providing service to taxpayers.

**Consolidate and revitalize IRS office space: \$10 million.** With this additional funding, the IRS will be able to consolidate office space in Atlanta, GA, and design a new, modernized facility for processing tax returns at the IRS campus in Covington, KY. These activities, in turn, will allow the agency to improve efficiencies and achieve long-term savings.

**Enhance IRS procurement and security systems: \$31 million.** This additional funding will allow the IRS to improve the efficiency of our procurement processes and also improve security for our employees and our resources.

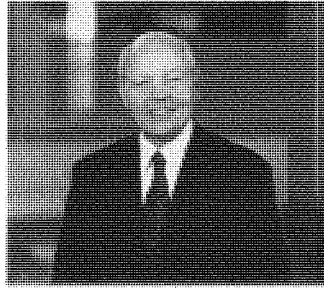
**Improve IRS financial accounting systems: \$12 million.** This additional funding will help the IRS ensure more timely and accurate reporting of data on the revenue we collect. The funding will also allow the IRS to make necessary system and programming changes to comply with various federal mandates, and to stay current with internal changes made to IRS' tax processing systems for tax administration that also affect financial reporting.

#### IV. CONCLUSION

Chairman Crenshaw, Ranking Member Serrano and members of the Subcommittee, thank you again for the opportunity to update you on IRS operations and discuss the FY 2015 President's Budget request for the IRS. It is vital that we find a solution to our budget problem, so that the IRS can be on a path to a more stable and predictable level of funding. I look forward to working with Congress and this Committee to do just that. In order to ensure that the IRS can continue to deliver on its dual mission of providing quality taxpayer service and ensuring compliance with the nation's tax laws, I hope that one of the legacies of my term as IRS Commissioner will be that we put the agency's

funding on a more solid footing. This concludes my statement, and I would be happy to take your questions.

## Commissioner John Koskinen



**John Koskinen** is the 48th IRS Commissioner. As Commissioner, he presides over the nation's tax system, which collects approximately \$2.4 trillion in tax revenue each year. This revenue funds most government operations and public services. Mr. Koskinen manages an agency of about 90,000 employees and a budget of approximately \$11 billion.

In his role leading the IRS, Mr. Koskinen is working to ensure that the agency maintains an appropriate balance between taxpayer service and tax enforcement and administers the tax code with fairness and integrity.

Prior to his appointment, Mr. Koskinen served as the non-executive chairman of Freddie Mac from 2008 to 2012 and its acting chief executive officer in 2009. Previously, Mr. Koskinen served as President of the U.S. Soccer Foundation, Deputy Mayor and City Administrator of Washington D.C., Assistant to the President and Chair of the President's Council on Year 2000 Conversion and Deputy Director for Management at the Office of Management and Budget. Mr. Koskinen also spent 21 years in the private sector in various leadership positions with the Palmieri Company, including President and Chief Executive Officer, helping to turn around large, troubled organizations. He began his career clerking for Chief Judge David L. Bazelon of the DC Circuit Court of Appeals in 1965, practiced law with the firm of Gibson, Dunn and Crutcher and served as Assistant to the Deputy Executive Director of the National Advisory Commission on Civil Disorders, also known as the Kerner Commission. Mr. Koskinen also served as Legislative Assistant to New York Mayor John Lindsay and Administrative Assistant to Sen. Abraham Ribicoff of Connecticut.

Mr. Koskinen holds a Law Degree from Yale University School of Law and a Bachelor's Degree from Duke University. He also studied International Law for one year in Cambridge, England. He and his wife Patricia have two grown children and live in Washington, DC.



## SPENDING PRIORITIES

Mr. CRENSHAW. Let me start out by asking a question about spending priorities. When you were here before, we talked about the fact that how you spend the money is just as important or almost important or pretty close to as important as how much money you have.

And I guess Mr. Serrano mentioned that 2010 you not only received a record high amount of funding, it was actually more than the IRS had asked for. You weren't at the IRS at the time.

But, actually, instead of hiring more revenue agents, like it said it was going to do, the IRS spent a record amount of money on travel and training.

And so now we find out that you have been struggling to come up with \$30 million to finish migrating to Windows—I think they call it Windows 7—

Mr. KOSKINEN. Yes.

Mr. CRENSHAW [continuing]. Even though Microsoft announced in 2008 that it would stop supporting Windows XP past 2014.

So I know you probably wish you had already done that instead of making those videos and wasting that money, that is all hindsight.

But just tell the subcommittee how we can be confident that you have got the correct spending priorities when, in the past, some of the excess funding got spent on silly videos and things like that.

So, for instance, the \$30 million that is going to Windows; I think you are going to take that from enforcement, but tell us what that means. Is that more important to the IRS than the revenue agents?

If you ask for a \$350 million increase for enforcement next year, then part of that money is going to come out for the IT.

Just talk a little bit about how you decide what are the priorities and how you spend the money.

Mr. KOSKINEN. It is an important question that I am delighted to answer and, as I say, keep you advised.

Wherever you think we were in 2010, we are now 10,000 fewer people and, depending how you count, \$850 to \$1 billion less. So whatever might have been excessive in that budget has clearly been squeezed out.

At the same period of time, over the 4 years, the number of taxpayers has increased by somewhere in the range of 6 to 8 million. Plus, we have additional responsibilities provided by Congress, including implementation of the Foreign Account Tax Compliance Act and the ACA.

So our problem right now is not around the edges. Our problem goes to the fundamental issues of what we can do. And that is one of the reasons I tried to highlight in my oral statement the priorities we have.

If you think about it and step back, we have two major areas of activity. We do taxpayer services—trying to make it as easy as possible for taxpayers to figure out what they owe and to make the payments. And we have tax enforcement and collection—trying to make sure that those not willing to pay, those who are actually trying to cut corners, pay their fair share, so that when you pay your taxes, you are confident that everybody is paying their fair share.

So those are two sides of the same coin, as far as I am concerned, and we are understaffed in both areas. As you know, our telephone service level is about 60 percent for 2013. During the filing season now, it is a little above 70, 72 percent, because we spent a lot of time and effort answering as many calls and questions as we could.

But for the year, because we don't have much more money now than we had then, we think it is going to be at 60 percent, which means 40 percent of the calls, over the course of the year, don't go through.

There are long lines at our assistance centers, and we think, again, it is unfair to taxpayers not to provide them the level of service, I think we would all agree, they deserve.

On the enforcement side, we have close to 5,000 fewer revenue agents and officers than we had 4 years ago. So under this budget, we wouldn't replace all of them, but we would replace a significant number of them.

In terms of our Criminal Investigation department, they have 350 fewer people than they had 4 years ago. They are concerned that they will be down 500 people at the rate we are going. All of that personnel would generate significantly increased revenues.

As noted, our estimate is, if we had the additional funding—the \$1.2 billion, \$1.3 billion—in the budget, we would return \$2.1 billion to the government, significantly more than the amount of money we are seeking.

In information technology, this year we have close to \$300 million of projects on the board to improve the operations of the IRS, but they are not being done because of the funding shortfall.

I view it as, and refer to it as, driving a Model T with a lot of things on top of it. We are the classic fix-the-airplane-while-you-are-flying-it attempt.

Windows 7 is part of that. You are exactly right. It has been some time since people knew Windows XP was going to disappear.

The problem with Windows 7 is, if we don't make that fix, which we are trying to finish up now, Windows XP will no longer be serviced. So all of the security issues that are continually updated no longer will be updated.

So we are very concerned that, if we don't complete that work, we are going to have an unstable environment in terms of security.

So we are significantly understaffed virtually everywhere. We are not talking about doing anything very exotic. We are not talking about making new videos.

Last year we cut training by over 85 percent. Now, whatever you thought about the training budget, cutting it over 80 percent couldn't have been the right answer. So we are going to spend more money on training. We will spend more money on travel.

But it is all going to be focused on trying to make sure that new and existing IRS employees are appropriately trained to be able to deal effectively with the taxpayers, whether they are dealing with them as taxpayer services representatives or they are dealing with them as revenue agents and officers.

So they are, for me, fairly simple, straightforward priorities, things we have to do that we want to do better than we are doing now. And at the back of all of that, behind it, is we have to implement FATCA and the ACA. We have no choice about that.

## BONUSES

Mr. CRENSHAW. Well, thank you.

When you were here before, we talked about some of these issues about how you spend the money. And one of the things that we talked about at that time was that only 60 percent of the telephone calls were being answered, but we also talked about the fact that you had decided to pay \$63 million in bonuses that your predecessor had decided he wasn't going to do.

And if you look at fiscal year 2015, I think the travel budget increases by \$58 million which is in addition to a \$44 million increase this year.

And so you have to ask the question: Is the travel more important than answering the phone calls? Is it more important than upgrades and IT? Talk about those priorities.

Mr. KOSKINEN. Again, a good question.

We have 90,000 employees spread across 500 offices. As Congresswoman Lowey mentioned, I have now been to 20 of them and talked to over 8,000 employees.

The travel we are talking about is related to both managers being able to visit and see their employees. It's about employees, when we are not able to appropriately and effectively do training with regard to computerized or video conferencing, actually having to travel someplace with trainers to gain the training as we go forward.

And this is training not just for new employees. This is training to upgrade the skills of existing employees in the Agency. So there is nobody going to fancy places.

The last training we did was in New Carrollton. As I told somebody, it was pretty easy for me to approve it. And we have much more rigorous approval levels than we have ever had before.

And so all of that is focused on trying to make sure, again, that the employees working for the Agency have the right tools to be able to deal effectively with the public.

## LEVEL OF SERVICE

Mr. CRENSHAW. For instance, is there an increase in the money that will be used to answer the phone this time?

Mr. KOSKINEN. Yes.

Mr. CRENSHAW. If there is more money for travel, but is there also—there probably is. Tell us a little about that.

Mr. KOSKINEN. Yes. The level of service last year in 2013 was about 60.5 percent. We worked very hard to raise it. We have got a better Web site. We think it is going to be a little higher, but it is going to still be in the low 60s.

With these funds, we would have a level of service—including an additional 11 million call demand for ACA up to 80 percent.

In the golden days in the mid-2000s, we were at an 88 percent level of service. Probably we would never go above 90 because then you have people waiting for the call.

But we think we could get to 80 percent. That would be our goal. And we would be willing to be held accountable to see if we couldn't do that. It would mean, overall, we would answer about 12 million more calls.

And I think that, beyond that—we used to measure how long you had to wait on the phone in seconds. In fact, we still do it, but the seconds now are running into anywhere from 15 to 25 minutes for the calls to get through. So it is one of the highest priorities.

I have given you in this statement our priorities. One is to raise the service level from 60 to 80 percent. The other is to increase enforcement. We think we will collect \$2 billion more from people who are cutting corners or not paying at all, including foreign tax cheats and avoiders. And the third would be to improve our information technology system to allow us to effectively absorb the responsibilities for ACA.

I would note the ACA implementation requires us to change our tax filing process. For the vast majority of Americans, they are going to check a box that says they have insurance and they won't be affected either way by the Affordable Care Act.

But for those who have gotten Premium Tax Credits paid to the insurance company, not to them, we have to reconcile those. They are based on an estimate the individuals have made of what they would actually make in 2014, just the way we all estimate how much money should be withheld.

All of that has to be reconciled, all of that in the middle of the filing season. So one of the reasons I have tried to make it clear that we have no choice, if we can't implement the Affordable Care Act, it means we won't be able to run the filing season effectively.

And, as you know, we collect, net of the \$300 billion in refunds we sent out, about \$2.5 trillion, so any negative impact on the filing season dwarfs—the potential loss—dwarfs anything else we are talking about.

Mr. CRENSHAW. Well, thank you.

And I am happy to hear that the phone calls are a priority because, as you know, that is kind of the front door to the IRS and that is the first contact people have and it drives people crazy.

Just in today's world, people always want to talk to, like, a real live person, and I appreciate the fact that you are making that a priority because I think that would go a long way toward making people feel like they are getting the response they need. And I appreciate that.

Mr. KOSKINEN. Well, I just got an email yesterday. I have talked to over 8,000 employees now, and I have encouraged them to have information flow from the bottom up. And I have a mailbox so they can send things to me.

A common concern across all of those employees is just this issue. They feel badly that they can't answer the questions and provide the service to taxpayers that they want to provide. The email yesterday was to say, one of the things, to try to allow us to answer more calls.

We have told our call center operators that they cannot answer complicated tax law questions. We have to send people to our Web site. We can answer straightforward questions. You know, the common, "How do I file?", "Who is the head of household?" standard questions, but anything at all complicated, which we up until this year answered, we can't.

So this email was kind of a plea from a call center person saying, "You know, I just feel badly when I can't tell people this. Isn't there

some way we could actually answer those calls? Because we know how to do it.”

And I had to write her back and say it was a difficult choice people had to make to try to figure out how to process as many calls as we can.

And the problem with complicated questions is they take longer so that, to try to keep the call level service up, we have had to tell people to go to our Web site, which is far improved over where it was a year ago, but still isn't the state-of-the-art Web site that we would like to have.

So, again, when we go to 80 percent, that would include the ability for us now, next year, and 2015 to answer those complicated tax law questions at the same time.

Because I couldn't agree with you more. The face for most taxpayers of the government and, really, the IRS, is when they call. And if they can't get through, they are unhappy. If they can get through and then can't get an answer, they are unhappy.

But we have people working in call centers for 15 or 20 years, which I always thought, “Gee, that can't be the most fun in the world.”

They do it because they feel that they are providing a service and, when they can answer a question, provide help to a taxpayer, they find that very rewarding and satisfying.

So I couldn't agree with you more. It is an immensely important priority for us.

Mr. CRENSHAW. Thank you.

Mr. Serrano.

Mr. SERRANO. Thank you, Mr. Chairman.

Speaking of phone calls, you may have a few when you get back to the office because you are now quoted as saying that New Carrollton is not a fancy place and—

Mr. KOSKINEN. I am sorry about that.

Mr. SERRANO. You might be getting some from New Carrollton.

#### LEVEL OF SERVICE

Let me ask you a couple of questions about restoration of services. In 2014, Congress kept the IRS at the sequester level with the addition of \$92 million for certain specific purposes.

How far does that go to us restoring services to the taxpayer that were reduced by the sequester?

And as a follow-up, the start of the filing season was moved back 10 days due to the 16-day government shutdown. Please tell us why the shutdown had that effect.

And are there other lingering effects that the shutdown had and, also, how the fact that we were still trying to restore services that we lost before affected you?

Mr. KOSKINEN. I would note, even with my concerns about the underfunding, we did appreciate the \$92 million of additional funding.

I don't want anybody to think that wasn't real money and that hasn't been used well. It was designated for customer service, Foreign Account Tax Compliance Act implementation, and then information technology. So \$34 million of it is going to customer service.

I will tell you, the complication is they estimate it takes \$6- to \$8 million to improve customer service levels by 1 percent. So part of the reason we think the tax filing season is going so well, in terms of an increased level of customer service, is we are able to spend that money and will continue to spend it through this year.

\$39 million will go to FATCA. And the reason we haven't provided the Committee with an operating plan yet for the \$92 million is the other \$19 million we are looking at is tied to the \$300 million of deferred IT projects we are trying to find which \$19 million are going to be the highest priority. And part of it may be in additional support for Windows 7.

We will give you the spending plan and then show you. We are using the money very well, but there are a lot of other things that are not being done that the \$92 million won't let us reach.

Mr. SERRANO. Right.

Mr. KOSKINEN. The shutdown, obviously, delayed the start of filing season. And so we didn't start until January 31. So it compressed it a little.

But, thus far, I am delighted to report the filing season has gone very smoothly. We have over 100 million returns already processed. Over 90 percent of them have been filed electronically. 70 percent or so of those returns are getting refunds electronically that they have already gotten.

So it is going very smoothly. Partially, it is going smoothly because there were no significant tax law changes for the average taxpayer. So for preparers and people filing returns, that went well.

It is also going better because a lot of people go to our Web site now and get information there that they used to get on calls, and that has helped us maintain a very low level, but still maintain it.

So our hope would be that we don't do it again because what happens in the shutdown is the entire IT department goes away for 2 weeks, 18 days, whatever the shutdown period is, and then simply can't make that up. That is why we had to delay the start this year.

#### TAX PREPARERS

Mr. SERRANO. Okay. You know, one thing that we have discussed on this committee for years—and this still bothers me—is these—I don't know how else to call them—fly-by-night storefront operations that seem to continue to creep up in many communities throughout this country and hurt the taxpayer.

I don't know if you read—there was a story that recently came out—maybe it was today—where a person went to get their taxes done and they were being charged \$400 for a very simple form and they said, "No. Don't file that. Forget it" and the person went ahead—the tax preparer went ahead and filed it anyway and took a fee.

I don't know how that happens that you take a fee from a return. And the person then was caught between two different places. This seems to be an ongoing problem, and I know the IRS has dealt with it.

Where are we with that or is that one that is out of hand?

Mr. KOSKINEN. It is a concern to us. Most tax preparers are well trained and they do a good job. 56 percent of people use tax preparers. Another 34 percent use tax preparer software. So the vast majority of them do fine.

There are people who are uninformed and undertrained and then are still preparing returns. Anybody in this room could go outside tomorrow morning and set up as a tax preparer. There are no requirements, no standards.

As somebody has noted, we regulate and register hairdressers in every one of 50 States, and in three States we register and regulate preparers.

And as H&R Block had said, you would think that you would care as much about your tax preparer as you do about your haircut.

So what happens is we have cases where we have fraudulent returns prepared by tax preparers. We have cases like the one you said, where they file a return, get the refund sent to them, then they either take their fee out and give the remaining part of the refund to the taxpayer, or they keep the refund totally themselves.

We have many numbers of cases of tax preparer fraud where the taxpayer then has to come to us and said, "I had a refund coming and I have never seen it. Where did it go?"

We had set up in 2010 a program to provide minimum standards and certification for preparers, and the courts earlier this year ruled we had exceeded our authority to do that.

So there is a hearing tomorrow in the Senate on tax preparers, and we will be supportive—I will testify and be supportive—of legislation from the Congress that would give us the ability and the authority to provide and guarantee minimum standards for anybody who is going to prepare a tax return.

And in low- and middle-income communities, particularly immigrant communities, people are comfortable working in the community. So if somebody sets up shop in the community center or refers to somebody's brother-in-law, a lot of returns are filed.

And our concern is not only the fraud or the excessive charges to the taxpayer, but if the tax preparer doesn't know what he is doing, we can get an inaccurate return.

So we than have to process back, talk to the taxpayer, trying to get just the right amount paid, which the taxpayer probably wanted to have paid to begin with.

Mr. SERRANO. Right.

Very briefly, do you think this is something that has to be done State by State or, from your viewpoint, could it be done from the Federal Government?

I mean, I know that we want less and less government, but this is one where I think both parties could agree that it is abuse.

Mr. KOSKINEN. There are at least three States who regulate locally. The tax preparer community has been supportive of a national standard, so you don't end up with 50 different standards. And if you are a company operating in two or three States or more, you have to then meet a whole lot of different standards.

We cleared the program—it was up and running for a while—with all the constituents and all the parties, and designed testing and the minimum standards it would require.

It wouldn't be a CPA exam. It would not be that difficult. You just have to show some minimal amount of competence, like a—

Mr. SERRANO. And what boundaries was it that the Court said you had overstepped?

Mr. KOSKINEN. Pardon?

Mr. SERRANO. What was it that the Court said you had done wrong?

Mr. KOSKINEN. The Court said we didn't have the authority. We could require people to register and get a preparer PTIN, which 600,000 preparers now have, but we couldn't require them to also take an exam—a competency exam—at the same time because there was not statutory authority for that.

So we still hand out PTINs. And a number of people took the test. As I noted, you know, about 75 percent of them passed it.

The other side of the coin is that means a significant number of people couldn't pass a relatively minimum test, which is an indication that maybe a little more education would be helpful.

Mr. SERRANO. Thank you.

Mr. Chairman, this is a very serious issue and I think one that maybe the Committee should take a closer look at. I don't know what we possibly could do at the Federal level.

And I know that the trend—and this is not a knock—is for less involvement by the Federal Government, but people are getting ripped off all over this country. And it makes their work harder. It makes the tax system look like a monster to a lot of people who want to pay their taxes.

When you have happen what the Commissioner just said, somebody capable of taking the refund—the full refund for themselves—I mean, I had no idea. I thought refunds went to somebody's house—they can go to a preparer and then he or she keeps it, that is fraud at the highest level and abuse at the highest level, and maybe we should look at it as something the Committee could speak on or do something about.

Mr. CRENSHAW. I think you are right. I think any kind of reasonable regulation to protect taxpayers is what we are all about. So that is a great point.

Mr. Womack.

Mr. WOMACK. Thank you, Mr. Chairman.

Commissioner Koskinen, welcome, and good to see you again. Funny you would mention hairdressers a minute ago. Every time I factor my—figure my taxes, I feel like I am getting a haircut. So, you know, it is kind of an interesting parallel there.

#### MEASURING LEVEL OF SERVICE

In your testimony, you said that, of the \$1.4 billion increase that you would request in 2015, that a couple hundred million of that, \$222 million, I think, would go to improve taxpayer service, and you said that it would allow you to answer 12 million more calls, get you to a service level of like 80 percent.

So can you share with the subcommittee on what metrics you used to kind of reach that. Was that just a simple math problem? How would we actually get to the 12 million additional calls? And how many personnel are we talking about? That sort of thing.



Mr. KOSKINEN. I asked the question myself, "How do we measure the level of service?", and you won't be surprised to find that it is a little complicated because you have to figure out, when you hang up, does that count or not count?

We actually electronically count every call that comes in. We count which ones then don't get an answer, where people wait and wait and then they just hang up. We count then the processing and who goes into our automated system, as opposed to who gets a representative. And it is a very detailed system.

We would be happy to get you the more complicated—you know, the way it actually works.

[The information follows:]

Customer Service Representative Level of Service calculation.

The numerator equals the assistor calls answered plus the automated calls answered through subject matter messages. The denominator equals the numerator plus emergency close disconnects plus taxpayers that abandon in queue waiting for Customer Service Representative assistance plus busy signals and disconnects generated by announcements that advise the taxpayer of high demand and request the taxpayer return his or her call at a later time.

But, actually, every call that comes in gets measured. We also measure how long it takes for that call to get through. And then, in our call centers, we measure how long the responses take, and we try to make sure that the call-takers are efficient so they don't spend a lot of time just chatting with the taxpayer. So there is a balance of wanting to give the right information, but as efficiently as we can.

It is a fully monitored system in which we are confident that we can measure exactly how many calls we are going to answer, and in what order, and how long it takes you to get through.

We used to be able to say you wouldn't have to wait more than 10 seconds to 20 seconds to get an answer. Now that is up into the minutes. So all of that is measured.

Mr. WOMACK. I think you said that people sitting in the queue sometimes 15, 20 minutes or more—

Mr. KOSKINEN. Yes.

Mr. WOMACK. That was part of your testimony.

Mr. KOSKINEN. Yes.

#### AFFORDABLE CARE ACT TELEPHONE CALLS

Mr. WOMACK. And I am assuming that part of the new line of questioning that you are beginning to receive is referenced to the ACA. Is that correct?

Mr. KOSKINEN. Haven't gotten much now because it doesn't affect anybody in terms of their tax return. But we estimate that, starting late in the fall and then into the filing season next year, as people look at the forms, we will get calls. Most Americans are going to check a box and they are going to move on.

But for those who have questions, preparers as well as people filling out the returns, our estimate is that we will get another 11 million calls just by the number of people in the program.

Because a lot of people who will be calling signed up. A lot of people will be calling who don't have insurance and will want to figure out exactly how they should be responding.

We already have started this year. We will work through the summer and into the fall to put out as much information to taxpayers as we can.

We are developing our Web site so it will be easy for people to get information. There will be a special section on the Affordable Care Act, to try to make the answers as easily accessible as we can for people, so they don't have to call.

But, inevitably, our experience is, whenever there is a new provision, you get a significant number of calls asking about it.

Mr. WOMACK. So to kind of preempt the anticipated surge in phone calls you are going to get regarding the ACA, I am glad you mentioned that you are going to do some things preemptively to try to push information out.

#### CHANNELS OF COMMUNICATION

What are the best management practices today in trying to reach the clientele that are trying to communicate with you?

Are there any things that we have learned over the last 3 or 4 years about people and their questions and the origin of their questions or their socioeconomic status or whatever that might help us better pinpoint how we direct and leverage the limited money we have to answer a lot of those questions?

Mr. KOSKINEN. It goes across a set of communication channels. We have now an online services group—small, but lovable—who are looking at just those questions. That is, how can we move people into the least expensive channel to get them the most information.

And the least expensive channel is, obviously, a Web site because, if you come there, the information is there. Other than just the cost of maintaining it, it is a relatively inexpensive way to get information out. So we spend a lot of time trying to improve it.

If you looked at the Web site a year ago and looked at it today, it is like it is a different entity, but it is still clunkier than we would like it to be. We would like it to be easily searchable, so that anybody used to going to Web sites could go there and find the information they need.

A lot of people and a lot of information goes out over things that I don't know much about: Twitter, Tumblr, YouTube. We have 100 videos on our You—

Mr. WOMACK. Those are kind of new to me, too.

Mr. KOSKINEN. Yeah. So we all have the same experience.

But there are YouTube videos telling you all sorts of information that you otherwise would be calling us to ask about.

On our Web site we have a "Where's My Refund?" app. Last year it had over 200 million hits. Not 200 million taxpayers. As I tell people, some people just can't resist pushing it and seeing each day how their refund is doing. But those are the people that used to have to call.

This year, for the first time, you can authenticate yourself and ask for previously filed returns. So instead of having to call us or come to our assistance centers, you can actually print out your last year's tax return and, if you need it for a mortgage or for employment or anything else, you don't have to call us about it.

So what we have discovered is kind of axiomatic, that younger people tend to be in social media, so as much of our outreach goes there as we can. Significant portions of the population are now used to using Web sites. They go to shop on Web sites. They do their banking on Web sites. So, again, we have been way behind and we need to be better at that.

There will be, inevitably, a percentage of the population uncomfortable with all of that, who will be uncomfortable filing electronically. They are in a paper generation and they are going to stay there.

And part of our commitment is we need to be able to deal with those people as well. I never want anybody to feel they have got to do something they don't know how to do or are uncomfortable with.

#### NEW HIRES

Mr. WOMACK. How many new people are we talking about?

Mr. KOSKINEN. Pardon?

Mr. WOMACK. Taxpayer service, how many new people?

Mr. KOSKINEN. How many new people? We are talking about as many as a couple thousand.

Mr. WOMACK. And then, to take one of those couple of thousand people, to get them from zero to trained, what kind of a timeframe are we looking at?

Mr. KOSKINEN. We have what we call seasonal employees. We are, to some extent, a seasonal business. We obviously are in the middle of that season right now.

And so we have people who work, sometimes, anywhere from 6 to 8 to 10 months in that filing season. And we hire those people and train them, and it takes 4 to 6 weeks to get them just the basic training they are going to need.

And, usually, the way we have streamlined it, is people get trained in answering certain questions. So when you go to the phone, it will ask you to select what your question is, and then that will send you to somebody who knows that area.

Now, with our more experienced call center people, they can actually answer some other questions as well. So part of the challenge for us is, if I am very good at answering head of household questions and the fundamentals, and you have another question, if I haven't been trained in that, I have to say, "Excuse me. I have to send you to—" and then there is a place where you send them to somebody who is an expert in that.

Done well—and that is where we would like to get back to—you would have people at the call centers who have a broader base of information.

So when somebody calls, even though they pushed, "My call is 'Where is my refund?'", if that caller has another question, I would like to increase the likelihood the person on the phone could answer that other question for you. But for the basic training, 4 to 6 weeks.

Mr. WOMACK. Thank you.

Mr. CRENSHAW. Thank you.

Mrs. Lowey.

Mrs. LOWEY. Thank you.

Mr. Commissioner, I would like to follow up with my colleague's question before because I would like you to get a little outraged about these scams out there and I wonder what you are doing either in social media or signs.

The storefronts open up and innocent people come in. They don't know whether that person is legitimate or not. And then suddenly, after April 15, the storefront closes and there are an awful lot of people who are just taking the refunds and going off.

#### IDENTITY THEFT

And a similar scam that I have been hearing about which is of great concern to me, criminals are using the IRS to steal the identity of innocent taxpayers. They claim large refunds. They profit by the fraud. And the number of taxpayers affected by identity theft has more than doubled since 2011 alone.

A recent Inspector General report released last year stated that billions of dollars had been fraudulently paid as a result of identity theft. And, shockingly, it is my understanding that amounts to as much as \$21 billion in fraudulent refunds could be paid out in the next 5 years. You know, this is just a slap in the face to hard-working taxpayers, and I wonder what you are thinking about that.

What steps has the IRS taken to halt these criminal actions? Does the budget request include adequate funds for enforcement to adequately combat this problem?

Mr. KOSKINEN. It is a critical problem. I would start by noting that people are not stealing identities from the IRS.

What is happening in refund fraud is criminals—and it is increasingly organized crime and organized syndicates—are stealing, borrowing, buying, however they get it, Social Security numbers outside the IRS. We have never had any incident, of any size, where somebody got that information from us. But they do get it.

Sometimes it is from the Death Master File. Sometimes it is for kids. They get the Social Security number, fill out fraudulent numbers that show they are entitled to a refund, file it electronically, and then get paid.

And they are not filing one or two of these. Some of these people are filing hundreds or thousands at a time. It exploded in 2010 to 2012. Overwhelmed law enforcement. Overwhelmed our resources as well.

We have devoted 3,500 people who do nothing but work on this problem. We are working with State and local law enforcement, with all the financial institutions, with the Bureau of Prisons, because that is where some of it started, with people in prison. We have developed sophisticated filters that identify where the scams are coming from.

Last year, we estimate, we stopped just a little less than \$18 billion in fraudulent refunds from going out the door.

But, of course—and in the IG report, we are all trying to figure out, “What does that mean in terms of you don't know what you don't know? How much is going out?” And we have done audits and we are doing algorithms that project that.

Part of the additional funding here would allow us to upgrade our IT because right now our filters can only be adjusted in between filing season. This Model T does not allow us, on the run,

to adjust the filters. Some portion of the IT money here would go to what we call the Return Review Program, which would allow us, as we see scams, to adjust immediately.

We also are taking a hard look at, and one of our legislative proposals is, moving the filing of W-2s with the IRS up to the end of January, the way it is for employees. We don't get the W-2s that go through Social Security until the middle of March.

As I have told people, we have gotten to be too efficient. In the old days, when I was younger, you sent a check, it took a while to get it deposited, and it took months before you got your refund. Now we tell you that, if you file electronically or on paper, we will get you a refund in 21 days, but the problem is we have leapfrogged the third-party information.

And then the final piece is we have ramped up, from 2012 to 2013, by multiples of four and five the number of investigations, indictments, prosecutions and convictions. Last year we recommended over 1,000 prosecutions. We had 400 people sent to jail for a long time. These are not 6-month sentences.

I just met Friday with U.S. Attorneys for Indiana and Northern Illinois about our cooperative efforts prosecuting refund fraud and other cases, and we have got partnerships across the country.

It is a significant problem. If you ask me what are the four or five things we focus most on, refund fraud and identity theft is one of them.

Mrs. LOWEY. Do you have adequate resources in order to do what you have to do?

Mr. KOSKINEN. Well, as I said, right now we have this mechanical clunky system that doesn't allow us to respond on the spot. A significant part, \$65 million or more, of the IT request would allow us to, in fact, become quicker on our feet.

If we don't become quicker on our feet, we will still get better because the filters are very sophisticated. We just can't adjust them. And part of what is happening is people are reverse-engineering.

You know, you file 1,000 fraudulent returns and see which ones go through. You can pretty quickly try to figure out, okay, what we are looking at, and then you adjust on the run. They can adjust faster than we can adjust.

Mrs. LOWEY. Well, thank you, Mr. Chairman.

I do hope that we will give you the resources so you can continue to pursue these crooks out there, and I thank you very much for your attention to it.

Mr. CRENSHAW. Thank you, Mrs. Lowey.

And I think somewhere I read that some address like in Atlanta, Georgia, got like 2,000 refunds. Somebody stole their identities, listed the address in Atlanta.

Is that close to the truth?

Mr. CRENSHAW. A, it is true. B, there are some places where multiple refunds legitimately go. Some preparers get the refunds. Some retirement communities. There are groups of people who file and it all goes to a single address.

But one of the issues is being a little slow in responding. As we go forward, we think we have got a way to stop that. It is all mechanical.

I went to Detroit just Thursday and watched. We send out 200 million notices a year to people. And I watched the computer program at work. I mean, it is like an assembly line, this big set of machines that have to crank out those notices and file them.

You process 150 million tax returns, as we will this year. I mean, it is a stunning number when you try to figure out what does that look like.

So part of the reason and the way we are able to process refunds so quickly is they are processed automatically. So we have to build in the filters that say, it makes no sense to send a whole lot of refunds to that address. Banks are stopping refund fraud when they see it and sending us the money back.

But, you know, it is like the old Whack-a-Mole. You knock him down here and it comes up over there. But one of the big issues was looking at it and saying, "Well, you know, if there are more than 10 refunds going there, there has got to be some issue worth looking into."

Mr. CRENSHAW. Yeah. And the point being, we all know it takes money to do these things, but more money is not the only answer to all the problems in the world.

Mr. KOSKINEN. Right.

Mr. CRENSHAW. And I appreciate the fact that you are trying to kind of figure out process efficiencies, all those kind of things, trying to stay ahead of the bad guys.

Mr. KOSKINEN. Right.

Mr. CRENSHAW. Mr. Graves has joined us.

Mr. GRAVES. Thank you, Mr. Chairman.

Commissioner, good to see you again.

#### AFFORDABLE CARE ACT PREPARATIONS

I know your statement references your preparation for how the Department will begin handling the healthcare law implications within your arena. And I guess we are about 53 weeks away from the individual side beginning—

Mr. KOSKINEN. Actually, less than that. The individual side has to be up and running at the start of filing season, so January.

Mr. GRAVES. Could you maybe tell us a little bit about that and some of your preparations, and I know you indicate in your comments here that a lot is under way, and maybe, bring some clarity to how the verification process works, whether individuals in fact do have the appropriate health care coverage that is demanded under the law.

Mr. KOSKINEN. Right.

Mr. GRAVES. How the penalties will be assessed, or I guess you refer to them now as the individual shared responsibility provision. Is that only through a refund, or is that outside of a refund? Is there some other mechanism that occurs? And then when you are finished with that, maybe clarity on the differences between individuals and then small business owners who are currently filing this year for 2014's taxes as well.

So a couple of different things there, but to bring clarity, and I will be happy to follow up.

Mr. KOSKINEN. I will do my best to do that. As you can understand, it is a multifaceted issue.

On the front end, in terms of just how the program runs and refund fraud that we are talking about there, what are the fraudulent filings, let's say for the vast majority of Americans, they have got insurance, they have got Medicare, whatever it is, so this is all going to be beyond them. They won't be affected by it.

If you apply for an Advance Premium Tax Credit, the money doesn't go to you, it goes to the insurance company from whom you are buying the policy. At the front end, there is less incentive for people to fraudulently try to claim the money because it doesn't go to them, unless you have got an uncle at Blue Cross you would like to get a bigger premium. Everybody is making a guess, an estimate, as to what they are going to earn this year to figure out what Premium Credit they are entitled to, and that is going to the insurance companies.

In filing season next year, when those people file, they are going to actually know how much they made and they are going to have to reconcile the amount of the credit, and they will either owe us money or we will owe them money. Some people could not get the advance credit during the year and would apply and say, "okay, I bought this insurance policy, here is my income, I now get a refund." That refund would go directly to them, but it only goes to them if the insurance company which is sending us all this data verifies that the filer actually had a policy. So you can't get a credit independent of the policy.

Now, the processing of all that is, as I say, just in the middle of filing—

Mr. GRAVES. You will receive information from the insurance company.

Mr. KOSKINEN. We are going to get information starting through the year.

Mr. GRAVES. To begin pairing that together—

Mr. KOSKINEN. And we are going to be able to verify coverage. It is like getting W-2 information. It is third party information that will verify that you had a policy.

Mr. GRAVES. Okay.

Mr. KOSKINEN. So that the chances of your figuring out how to get money beyond what you are entitled to are slim in that case.

The problem for us, the challenge, IT challenge, is that all of this has to be built into our normal computerized filing system. So there are something like over 50 systems that have to be adjusted to take into account these calculations.

Then getting to the question about what do we do about enforcement? If you got too much credit, you will owe us the money and we will take it out of your refund, or you will pay it as a tax due. If you got too little, we will add it to your return and refund, or subtract it from the amount you owe as you go forward.

The question will be, "okay, I didn't buy. I was supposed to buy insurance, I didn't buy it. I have a responsibility payment, penalty, however you would call it, of \$95 or 1 percent." The statute limits our ability to collect on that. We can deduct it from a refund, so if you owe us \$95 and otherwise would have gotten a \$500 refund, we will subtract it.

But if you owe taxes and pay taxes, but now you don't pay the \$95 and we assess it, we can't levy against you. We can't do the

usual enforcement. We can write you a letter and say, "hey, you owe us the money," and next year take it out of a refund, but we have limited enforcement ability against you. It is easy to understand, but that is another complication for our filing return systems because then we have to be able to identify that what you owe us is tied to the responsibility payment, not normal taxes. Because if it is normal taxes, you go into our normal collection and enforcement process.

Mr. GRAVES. Which is a penalty system—

Mr. KOSKINEN. We have to have a computer system. The penalty system goes into a modified collection process. So the computer system has to recognize all that and be able to say, "all right you owe us \$95 but that is what you owed us because you earned and didn't pay enough in withholding," or "you owe us \$95 and that is because you didn't buy an insurance policy," and now we are actually going to collect from you in a different or modified way than before. So that the—

Mr. GRAVES. Could I ask another question on that?

Mr. KOSKINEN. Sure.

Mr. GRAVES. So, if you have unpaid taxes there is penalties and interest.

Mr. KOSKINEN. Right.

Mr. GRAVES. That date back to the time the taxes were due. Is that the same that the Supreme Court ruled—

Mr. KOSKINEN. My understanding is if you owe the money, you owe the money. There are limits of what we can do to chase you for it.

Mr. GRAVES. Okay. So are there penalties and interest if somebody doesn't pay their \$95?

Mr. KOSKINEN. Yes. My understanding, although that is the first time anybody has asked that specific question, so I will double-check to make sure I am right, but my understanding—

Mr. GRAVES. And the reason I asked is because the Supreme Court I thought ruled this a tax—

Mr. KOSKINEN. Yes.

Mr. GRAVES. And you continue to use, and everybody does I guess, the individual shared responsibility provision. And so I am curious if it is being treated the same as a tax.

Mr. KOSKINEN. It is. It is partially because we can collect from you in the way we normally do, short of filing a levy or chasing you. That is my understanding. It is like money you owe us. We will take it out of next year's refund and there are penalties and interest applied.

[The information follows:]

I have verified that the SRP established in section 5000A to which you referred is payable when the IRS issues a notice and demand for payment. Therefore, an individual is not required to pay the SRP as part of quarterly estimated tax payments, and the IRS will not impose estimated tax penalties for a failure to pay the SRP with estimated taxes. The statute provides special rules for the assessment and collection of the SRP. A taxpayer who does not timely pay the SRP is not subject to criminal prosecution or penalty for the failure; however, interest accrues on the SRP from the due date for payment specified in our notice.

Mr. GRAVES. Okay, and if I could ask one more, Mr. Chairman.

And then as far as small business owners who are filing quarterly currently, are they required to begin that process now, seeing



how they are paying their quarterly taxes today? Because I think there has been some dispute as to whether or not they wait to—

Mr. KOSKINEN. Until the end of the year.

Mr. GRAVES. To the end of the year, to the 2015 filing backwards, but because they pay quarterly now as small business owners, as individuals or sole proprietors, I assume?

Mr. KOSKINEN. That I don't know the answer to, but I will get back to you very quickly because that is a straightforward simple question and I will get back to you in the next few days.

Mr. GRAVES. Okay, thank you, Mr. Chairman.

Mr. CRENSHAW. Mr. Yoder just walked in. He is collecting his thoughts.

Mr. KOSKINEN. He and I are suffering from the NCAA tournament together.

Mr. CRENSHAW. I hope you didn't have anything to do with Duke losing to Mercer, because I think that knocked out about 99 percent of all of the people.

Mr. GRAVES. What is wrong with Mercer?

Mr. CRENSHAW. Nothing, but I don't think anybody other than you, Mr. Graves, picked Mercer to beat Duke. So a lot of unhappy people.

#### TARGETING PROHIBITIONS

Okay, well let me ask a quick question. I mentioned in my opening statement that we had the omnibus bill last year that was bipartisan and we put language in there that said you can't use the funds to target certain groups. We said you can't use money from the funding to target certain citizens for rights guaranteed under the First Amendment. We said that we were going to require videos that were produced by you all to be subject to appropriate review.

And so my question is, why didn't your budget request include those three prohibitions?

Mr. KOSKINEN. Because for years, OMB, whoever the Administration was, has always opposed riders on appropriation bills, whatever they say. This was a decision made by the Administration and OMB to, again, continue to oppose any riders.

I would note, that as far as I am concerned, I think taxpayers have a right to expect to be treated fairly, not only under the Constitutional rights, but they need to understand that no matter who they are, whatever organization they belong to, whoever they voted for in the last election, when they deal with the IRS in any way, they need to feel they are going to be treated the same way everybody else is. If we contact you it is because we have a question about something in your return, and that is the only reason you are going to hear from us. And if somebody else had that same issue in their return, they would hear from us in the same way.

So my sense is we don't need a rider. If you want to put another one in, that is fine, but I don't think we ought to need a rider, and we certainly don't as long as I am there. I will just say I think people ought to be treated fairly. They ought not be singled out because of anything other than whatever they are filing with the IRS. And so my strong view—

Mr. CRENSHAW. So you don't, you know, plan on doing those activities this year.

Mr. KOSKINEN. No.

Mr. CRENSHAW. You wouldn't have any problem if we were to prohibit those activities in this year's bill?

Mr. KOSKINEN. No. As I say, I know, having been at OMB 20 years ago, although I was on the management side, and even when I was in the city, any time riders are put into appropriations bills, the recipients say you ought to do that separate from it. And so they will continue. It will always be that dialogue and response back.

But as I say, we are not going to do it anyway. Whether you add the rider or leave it out or change the language in it, it is not going to affect the way we behave.

Mr. CRENSHAW. That is good to hear. I do think sometimes riders make their way into requests, but that is not your call to make and I appreciate that. But I think there are probably some things, in the request the Administration made this year, so whoever makes that decision is not always absolutely consistent. But, again, that is above your pay grade.

Mr. KOSKINEN. Right.

#### 501(C)(4) DRAFT REGULATION

Mr. CRENSHAW. Let me ask you about the 501(c)(4) regulation. We talked a little bit about this when you were here before. And as you know, the Chairman of the full Committee, Mr. Rogers, and some others, the House leaders, wrote a letter to ask you to withdraw the draft of the 501(c)(4) regulation, which I would probably agree with but I don't think you agree with that, and as far as I know, you continue to move ahead. We talked about the fact that the number of comments grows almost daily. Last report I had was there were 150,000 comments. Are we getting higher than that now?

Mr. KOSKINEN. Well, the last estimate I had from Treasury which keeps of track of these, although I don't know who counts them, but anyway is it is just above 150,000.

Mr. CRENSHAW. Got you. As kind of a perspective, I understand the XL Pipeline, which is pretty controversial, had about 7,000 comments, and so, evidently there are a lot of people that are interested in this regulation.

And so, you talked before that maybe something that controversial you might republish the rule and ask for even additional comments. Can you give us an update on what your plans are?

Mr. KOSKINEN. Yes, as you know, this draft proposal was put out, it is actually convenient, two weeks before my confirmation hearing just to make it more interesting to have that confirmation hearing. I don't know how it about came about and what they did with it.

My view and I have said publicly on numerous occasions, is that I do think clarity would help. While I don't control the process, I do think that any regulation that comes out finally ought to be fair to everybody, ought to be clear and ought to be easily administrable.

In light of the comments, which are voluminous, there will be a public hearing at which people in the public, as well as the Congress, can testify. They will have to figure out a way to screen everybody, otherwise we could be there for weeks. There will be a public hearing.

In light of the comments, a lot of them I haven't seen, but I know that some of them are long and thoughtful, and I assume a number of them will be. I think there is a reasonable possibility we will have to reissue, redraft a proposal which would go out again for public comment.

I originally said, when we had about 25,000 comments, that I thought the chances of getting a final regulation through the process before the end of the year were slim. At 150,000 comments, all of which we have an obligation to consider, I think that it will be the end of the year, probably, before we get to it.

But I do think that we should be moving from a "facts and circumstances" test which doesn't give people running the organization any more clarity than it does IRS people trying to figure out whether they apply or not. If you had a regulation that was fair to everybody—it didn't discriminate one group against another, it didn't encourage you to form yourself one way or another, it was just a fair, straightforward, clear and easy to administer set of rules—you would then make it a lot easier for people running these organizations to feel comfortable that they know what to do, and they can do every day, and they are not risking their exemption. Again, wherever they are in the political spectrum, they are all in the same boat.

Mr. CRENSHAW. Well, you know, there was a lot of concern when it was first published whether it was going to happen before this year's election cycle, was on the tip of everyone's tongue, and from your testimony it sounds like it won't happen before the end of this year which won't happen before the elections in November. Is that still your best judgment?

Mr. KOSKINEN. That is my best judgment.

#### COST OF PREPARING 501(C)(4) REGULATION

Mr. CRENSHAW. Tell us, and this has to do with priorities, but how much staff time have you at the IRS spent on preparing the regulation and reviewing the comments? Because that gets into where your priorities are, but have you got have an idea of how much time and energy and money has been spent on promulgating this and then reviewing this?

Mr. KOSKINEN. I don't. The promulgation was all done and the discussions were before late November when it was issued. We are in the review process now. A lot of the comments are electronic. You can measure it. You go to the website and it will tell you how many they have counted on the electronic side, and then we have got paper ones to boot. So we are at the front end of that process of segregating them into who is in favor of what.

There are three big questions. One is what is the definition of political activity; the second is to which organizations should it apply across the 501(c)(3), (4), (5), (6), (7)s; and what is the amount of activity that you can engage in without jeopardizing whatever your qualification is. The regulation only proposed a definition of polit-

ical activity. It left open, and asked for comments, on the other two questions.

So we have to bucket as it were, there is probably a better verb than that, but anyway take these comments, put them into processes so we can actually know. Some of them will be repetitive, so you will know, okay, there were 5,000 that say this. I have seen a couple that are very thoughtful, like five page intellectual analyses of what should count, what the impact would be.

One of the questions is, "what is the impact on somebody who is a 501(c)(3) or a 501(c)(5)?" There are 1.6 million tax exempt organizations out there, and part of the reason for asking for comments was nobody knows exactly what all of them are doing. Garden clubs, obviously, one would think would not be involved.

So at this point, I could get you an estimate, but the time that it is going to take is really going forward, which is to try to work through all of those comments, then take them into consideration, have a public hearing, and then figure out what is an appropriate response to both the public hearing, all of the debate that has gone on, but in particular, an appropriate response to the comments.

Because, as I say, the purpose of them is you should read them, listen to them and benefit from them.

Mr. CRENSHAW. Well, my only point is that, that obviously costs something and in terms of you figure out your limited resources, you have got to make those judgments, that to try to do a rule like this fast would probably cost more money devoting more people you know, early on as opposed to doing it you know, in maybe a more thoughtful way that might take a little more time but also it might let you spread out the expense through all the staff.

Mr. KOSKINEN. Right. Well, that is the way we are going. I mean, there is no rush to judgment on this, to say "we got to get it out," and in fact, I think, personally, not the guy who controls it all, but the goal here is not to end up rushing to see if we can get it out in October, which would seem to me—

Mr. CRENSHAW. You still have to answer the phone along the way, right?

Mr. KOSKINEN. That is right. So we got to answer the phone. I think you are right, that we ought to address it in an appropriate, thoughtful way. Because I want people to feel comfortable when we come out with whatever we are coming out with, that it wasn't something that we just went through the motions with. That we actually listened and read and heard what the comments were, and the concerns were across all three questions; about the definition of political activity, to whom it ought to apply, and how much of it you could do without jeopardizing your exemption.

Mr. CRENSHAW. Thank you.

Mr. Serrano.

#### PURPOSE OF 501(C)(4) REGULATION

Mr. SERRANO. Thank you, Mr. Chairman.

Following up on that, you have released proposed regulations intended to provide clarity to the standards for determining the tax exempt status of 501(c)(4) organizations.

I understand that you have received over 150,000 comments and that public hearings will start soon on the proposed regulations; why did the IRS issue these proposed regulations?

Mr. KOSKINEN. Why?

Mr. SERRANO. Why?

Mr. KOSKINEN. I wasn't around so I can't tell you why. I can tell you, from my standpoint as a new guy on the block, having a standard that says "facts and circumstances," is difficult to administer, difficult for people running an organization to understand, on a rolling basis, how it runs, how to measure how much of it, it is.

So, just from outside the ongoing debate, it does seem to me if we came up with a rule that is fair to everybody, clear, easily administered, everybody would benefit. So I think it is worth the effort. But what was going on when people decided to promulgate it, it was a recommendation of the Inspector General.

Mr. SERRANO. Okay. That is what I was going to say. My understanding was—

Mr. KOSKINEN. One of his nine recommendations was the IRS and Treasury ought to put on their priority plan clarity, and so I am sure that was the major driver last fall.

Mr. SERRANO. Well, that is what I understood, that it was the recommendation of the IG, and while some may differ in a respectful way on how much time you spend on regulations, I think this particular one has caused enough heartache in this country, this whole issue, that we need to clarify clearly what is allowed and what is not allowed as much as we can so that people have guidance and so that we can stop talking about as much as we talk about it too.

Mr. KOSKINEN. Well, again, I would hope the public would feel comfortable of that, in light of the volume of the comments, but also that they come from everywhere. So we managed to generate interest across the entire political spectrum, across a lot of different organizations. It is a broader, which I think is appropriate, review and discussion than it might have been viewed, perhaps, in the past.

So I hope people would understand that everybody is going to be heard, and that, ultimately, while we may not satisfy exactly everybody, I think if it is a fair result, and balanced, and deals with everybody fairly, most people will, I think, be comfortable and think it is an improvement.

#### TAX GAP ESTIMATE

Mr. SERRANO. All right. Let me ask you something about an issue that we deal with all the time and sometimes I think doesn't get the attention it should. The tax gap, which was last updated in 2006, will the IRS be updating this statistic and if so when will you do so? And please talk about your efforts to address it, which can cost taxpayers or is costing taxpayers \$450 billion a year right now.

Mr. KOSKINEN. Actually, the tax gap was updated either in 2011 or 12, but it is on the basis of 2006 data. And the problem is it is a long, complicated process, so you are always out of sync and out of check with it. I have asked that question, to see, when is it meaningful? The tax gap number didn't change significantly be-

tween the earlier update. When is it meaningful for us again, with the resources we have, to undertake the research project it takes? It is a long analysis; you have to worry about taking into consideration all the information you get from audits. You do some additional audits to try to test where the compliance taxpayers are, how many other people are out there who should look like them.

One of the big improvements in attacking the tax gap is thanks to legislation passed by the Congress, which requires credit card companies to file what is called a 1099-K with anybody who has clients who use a credit card as well as with the IRS. So for the first time we will have third party information about what is going on in a big chunk of the economy. And the estimate has been about one-third of the tax gap is in that area. Everybody from gas station owners to mid-sized companies, who basically have been operating without knowing that we don't have any independent way, other than auditing them and going through their books and records, to know exactly how much they had in revenues and what their expenses were. Our experience is that compliance goes up significantly when people know you have got the data.

We are a tax compliant Nation. I think we deserve great credit for that. But part of it is because everybody knows we got your W-2. Sooner or later we are going to get your 1099. Now with FATCA we are going to find out who has assets in the Cayman Islands and in Switzerland. So my guess is that compliance is going to go up a lot, voluntarily abroad as well.

I think we are going to make inroads in the tax gap. It may actually make more sense a year or two from now, as we have begun to complete our pilots about how to use this information, how to deal with small and medium size businesses, to see what difference it makes. Because we know kind of where we were. There is no indication that the gap has changed significantly from about \$425 billion, less about \$50 billion that we collect. A lot of the collections are part of the tax gap obviously because those are people who weren't paying or didn't want to pay. So about \$375 billion was the net, and as I say about \$135 billion of that was the estimate in this area, and we are now able to deal with that thanks to the support we have gotten from Congress.

Mr. SERRANO. Do I have time for one more question?

Mr. CRENSHAW. A quick one.

#### BITCOIN

Mr. SERRANO. Sure.

You know, when you are in this room for sure you are on TV. I don't know if you are aware of this. The big room gets seen by the public, and hearing the word Bitcoin, could you tell us from a IRS perspective what is a Bitcoin, why did you decide to tax it as property and how challenging will that be in going through the returns and finding out the information you need?

Mr. KOSKINEN. I feel like Congressman Womack here. He and I are looking at Bitcoin just about the same way we are looking at some of the social media issues.

Bitcoin is a fascinating kind of intellectual challenge. The question is, "what is currency?" In the old days, really old, thousands of years ago, currency was whatever you bartered. Salt was a very

valuable commodity. People bartered, used salt as a currency. The Romans had old coins.

So the question is, “how does currency function?” and particularly here, “how does currency function when it is not issued by a government?” It doesn’t have anything behind it other than the transaction nature.

So, I think we are at the beginning of the discussion about what Bitcoin is and how it is going to work or what online non-governmental currencies are. The position that the IRS Treasury regulation took was, at this point, it is not a currency in the way we think of currency because it is not supported by any visible means and, therefore, it is a commodity. When you trade it, you can’t pay your taxes with it, but we recognize people are in commerce, trading it back and forth.

And what it says is you have to treat it as property, and that is, if you are making a profit or a loss as you trade the Bitcoin and buy something with it, you have to keep track of that, which will be complicated needless to say.

But it is not that different. Normally if you go to Europe and you buy Euros and they go up or down in value, you don’t pay any attention to that, you just use the Euro. You are, in effect, making or losing money, but you are not keeping much track of it.

Currency traders—people who trade currencies and treat them as property—they are making money on the change in the value. So, in effect, everybody who is in the Bitcoin business, it is as if they are a currency trader in Bitcoin and it is property, so you have to keep track of it.

Now, in the paper I read, there are people saying, “well, they are going to figure out ways to make it easy for you to figure out how much did you pay for your Bitcoins? And when you held them for a while and used them, did you make money on them or lose on them?”

As it is now, it is like a stock you have to keep track of yourself. In the old days that is what everybody had to do. You bought the stock and then if it went up or down, you had to keep track yourself as to what its value change was.

On the one hand, the IRS Treasury regulation accepts or validates that Bitcoins are out there and people are using them. There is enough real about them that, in fact, the IRS would say they are property. But it is an understandable position for the experts on this, of which I am not one, to take the position but it is not a currency at this stage.

Now, at some point in the evolution of time will it become a currency? Will it be traded or treated or supported as such? You know, who knows? But I think we are at the front end of Bitcoins. The issue recently was about whether you could suddenly lose track of where they are. They are electronic, so when whatever it was—Cox or whoever the company was that went under—if you suddenly had hundreds of millions of dollars of Bitcoins disappear, it gave you some idea that, well, this isn’t your normal currency.

And so I think at this stage the advice given by the Treasury and IRS was an attempt to start moving down the path of dealing with these currencies and transactions as they unfold.

Mr. SERRANO. Well, I thank you. If it doesn't make noise in your pocket it is going to be hard for us to understand.

Mr. CRENSHAW. Well, I will let you know, Mr. Serrano, without divulging, I don't know what the IRS implications might be, but as you look into the future, if you want to go take a ride in outer space, there are people that will allow you to pay for that with Bitcoins. So, just keep that in mind as we look to the future.

Now I will recognize Mr. Womack.

Mr. SERRANO. Is that where you are trying to send me?

Mr. WOMACK. Why would Serrano want to pay large Bitcoins to go to outer space when he has already been there a few times? That is a joke.

Mr. SERRANO. I went. No, No, I did, on Saturday night, and it was full of Republicans.

Mr. WOMACK. Yeah, I hear you.

Mr. Chairman, I think Mr. Yoder was next.

Mr. CRENSHAW. Well, if he has gathered his thoughts.

Mr. WOMACK. He has had plenty of time.

Mr. CRENSHAW. He didn't give me a signal.

Mr. YODER. I have had more than enough time. Thank you, Mr. Chairman.

Mr. CRENSHAW. Okay, great. Mr. Yoder.

Mr. YODER. Thank you, Mr. Chairman.

Commissioner, welcome back to the Committee. I want to thank you for something. You know, after the University of Kansas lost their second round basketball game in the NCAA tournament, it took a while for me to be able to even speak of that awful moment. But knowing that Duke had lost already really made it a lot easier for me to be able to get through my day. So, I want to thank Duke for losing and North Carolina for losing as well.

Mr. KOSKINEN. Once your team loses, you root for everybody else to lose. You become a great supporter of Dayton.

Mr. WOMACK. Remember the overall Chairman's team is playing tonight, so—

Mr. YODER. Well, and that is a problem for me as well because my wife is a Kentucky grad. So we will just move on to other topics.

#### FOREIGN ACCOUNT TAX COMPLIANCE ACT

I want to ask you a question on a few different topics. I want to start with the Foreign Account Tax Compliance Act. I understand that Treasury and the IRS have recently issued forms and rules to help alleviate problems financial institutions are phasing in complying with this new act. However, the Act is scheduled to be in effect starting July 1 of this year but existing law in some countries makes it impossible for some financial institutions to comply without an intergovernmental agreement, an IGA, in place to resolve those legal issues.

It is my understanding that fewer than 30 intergovernmental agreements have been signed by the U.S. and fewer than 30 IGAs have been tentatively agreed to. That unfortunately leaves many dozens of countries that have not reached agreement with the U.S. on how their financial institutions can comply with the FATCA.



So I have a few questions for you. One, what guidance can you provide to global financial institutions that are trying to comply but cannot because the U.S. has not reached the necessary agreements with many countries on compliance with FATCA. Secondly, would the IRS take the view that the inability to comply in one of many countries in which they do business might affect the treatment of the entire organization?

In other words, should the fact that the U.S. has not reached agreement with India, for example, mean that the entire foreign financial institution cannot be in compliance with FATCA even though it is in fact in compliance for all of its operations in countries where the U.S. has negotiated the necessary agreements?

And then lastly on this topic, would you be prepared to offer accommodations to financial institutions that are as compliant as they can be under the current law given the complexities of achieving the necessary cooperation of international taxing authorities?

Mr. KOSKINEN. Well, let me work in reverse.

Mr. YODER. Sure.

Mr. KOSKINEN. I would note that, much like the 501(c)(4) regulation, I don't control the guidance process. It is a joint effort, and ultimately Treasury is responsible for those things, and Treasury is responsible for tax policy as it relates to that. We are tax administrators, tax collectors. So the answers to most of your questions, which are very important questions for, obviously, the financial institutions involved, really are going to come out of the Treasury tax policy group.

But at this point, the good news is that Treasury has announced that—I think they have announced anyway—my understanding is if you have initialed the agreement and it is just waiting for final adoption, that will count. So we are getting close to 50 countries that either have a signed agreement or basically a negotiated agreement, that has been initialed by both parties and are now just moving toward a conclusion.

Fifty is a good number in the sense that it covers a lot of the countries that everybody has been focused on as we go. But it does raise—and there are a lot of other countries, you know, another 100, 125 easily—the questions you raise, and particularly the one I had not heard people discuss yet, but it does seem to me appropriate, is in this global economy, any number of financial institutions are operating in a number of different countries.

The good question is, “if I am in 30 countries, 20 of which have agreements and 10 don't, do I at least get credit for the 20 I am in that have agreements?” And, again, that is a question that Treasury would have to answer, but it does seem to me, logically, that you ought to be. If you are operating and your accounts are in a country that is compliant, that ought to count for something. But the problem is the penalty is withholding payments made on accounts you have here.

So it is going to be a more complicated answer than the logic of well, you ought to get some credit because you ought to for that. I will be happy to find out from Treasury where they are and whether anybody has asked that question. I know they are working, and most of the countries, are working very hard to get to the international agreement.

Some of the 50, a lot of the other countries, in effect have rules that allow the banks to provide the information directly. Some of the countries that had bank secrecy laws, which were part of their attraction for people as a place to have accounts, then discovered they were suddenly stuck in that message. But a lot of countries basically will allow their banks to provide that information.

So the real question is between 50 and 180, or whatever the number of countries are, how many of them have bank secrecy laws and no agreement, and that I don't know the answer to.

Mr. YODER. Well, your efforts to clarify some of these things will be helpful, and as I am sure you can imagine, there is a lot of confusion going out and July 1 is coming quickly. And there is this uncertainty. Our office gets questions, and so I pass those questions along to you and to extent you can help us clarify, great, and we appreciate your efforts in that regard.

#### EARNED INCOME TAX CREDIT

Shifting gears for a minute, I want to talk a little about the Earned Income Tax Credit. And I had some tax preparers in my office recently and we were talking about just the amount of fraud that goes on in this program. I know you are probably well aware of it.

It is a pretty stunning number. When you look at a program that has had upwards of 25 to 30 percent of the payments fraudulent, I think reports now are 21 to 25 percent of the earned income tax payments are fraudulent payments that go to folks that are not entitled or eligible for those benefits. And correct me if you have better more accurate numbers in a moment here.

What tools do you need to fix this problem? You know, we are talking \$10 to maybe \$13, \$14 billion in lost revenue or money that is going out basically from the Federal Treasury to folks that don't deserve those dollars. That is a lot of money, particularly when we are talking about trying to find money for Head Start and cancer research and things that could really help people, or reduce the tax burden for Americans that are already struggling in this economy. How do we root out that fraud, number one.

And then, two, the taxpayer suggested to me that there is a little bit of a loophole in that when they help someone prepare an earned income tax application they have to certify a list of questions that they are on the line for determining were accurately responded to, or at least that they asked the questions and sought answers, and they have had people when they have asked the question say, never mind, I am just going to file it myself. That way I don't have to actually answer those questions, and they described an online loophole that allows people to basically not have to attest to all of the same things they might have to attest to with the preparer.

What do you know about that, is that accurate, and what can we do to fix that problem as well?

Mr. KOSKINEN. Right. As I talk with employees, I tell them that even with our constrained resources there are a set of things we need to address, and they are what I call the visible issues. So we need to make sure filing season, which is the most visible, goes well, as it has this year. And the challenge for implementing the Affordable Care Act and FATCA next year, is to make sure that it

goes well because it ties directly into the filing season. So we are going to do that and I am committed to that.

In terms of other issues, we need to get the (c)(4) issue behind us. We are providing voluminous documents to the six investigative groups. It is not a resource issue, it is just, "can we ever get the document production completed and somebody issue a report." Because I said, once we have the report, we will take the facts, whatever they are, do whatever we need to do in addition to the things we have already done, and then we will move on. We need to do that.

We need to deal with a (c)(3) backlog that requires us—we are redoing the way small PTAs, as I call them, get processed. There is no reason they should get the same 31 page application as somebody that is going to spend \$2 million. And those are all visible and those are things we need to deal with. I think we have a program and we are in good shape for that.

We have a good story, as I just talked about, around a huge problem of refund fraud, where we have programs going. We are making a dent in it. I think we are going to—with a little bit more funding—actually make a bigger dent.

The area that is the last area that is visible where I don't think we have had a good story, is in fact the Earned Income Tax Credit. As you note, the improper payment rate has been 20 to 22 percent, and the amount of money improperly going out is \$12 billion to \$14 billion, and it has been that way for several years.

And it is not that the IRS has not tried a lot of things. They have tried a lot of different things and it seems to have made no difference. So I have told people that is an untenable position to be in. We need to let people know that we know it is a problem, that we recognize that. We think it is important to solve the problem, and we think that, in fact, there ought to be a way to deal with it.

I have had two long meetings with anybody who ever thought of this problem in the IRS to say, okay, don't tell me what we have done, that is fine, it didn't work. You know, we can't keep doing it expecting it to be different. What are the changes we need?

So your question is my question, and there are several things. One, have we disaggregated where does the improper payment comes from? Some of it is fraud by refund preparers who take the money and run off.

Some of it is improper payment, definitionally. The statute is very complicated about where the children are. There is relatively little fraud in the single taxpayer with no children. The maximum payment there is about \$600, so it is not a huge incentive to cheat, and the fraud there is just the understatement of income to try to make yourself qualify, and we have the usual ways of tracking that.

The real problem is the complexity around dependents and how many children you have and where are they. Are they with you, are they with your wife if you are divorced, are they with somebody's grandmother? How many different people are claiming them? And that is where the attestation comes in and people have to certify, "okay, I have got this many children and this is where they are."

We have spent a lot of time auditing these people, but it is clear we are not going to audit our way out of the problem. We have dealt with tax preparers because over 50 percent, 57, at one point over 60 percent of the returns were filed by preparers, and so they were a group we could educate about the problem. We could ask for their assistance to make sure they are comfortable that they are filing.

And your report is right, some people have said well, in that case I won't go to the preparer. I will just do it myself. And so, part of it goes to our goal of providing minimum standards in regulating preparers, but part of it is there are legislative things that would help us.

Two of them are—one is what is called correctable error authority, which would allow us if we see beyond just math errors, if we see an error in a return—we see them in particular in this area where we have information that says we don't think you have got the right number of children here—now we can't adjust that refund without actually auditing you. We don't have the authority to adjust it.

Now, if we adjusted it and had that authority we would tell you that we adjusted it. You would still have the normal rights to appeal or complain or explain. But we haven't got enough resources, and it wouldn't make sense for us in all of those returns where we see there is a problem, to then go out and try to audit. We do half a million audits in this area already. It is about one-third of the audits we do. So if we had correctable error authority it would be a big step forward.

The other thing we are asking for is authority to move the W-2 filings to the IRS by the end of January. We would collect some of the understatement of income from people. It would allow us to make sure that the fraudulent filers are out of there. The problem is a lot of EITC filers don't have W-2s. They make money and they file schedule C's, they are gardeners, they are working in assistance places where they don't get W-2s.

The third piece we are looking at is where we can get third party information, particularly about children. We have some of that in our dependent database. We need to make that improved and better.

And then the fourth, and we haven't gotten that far yet, is whether there is a way to simplify the statute. I have got to tell you, I have read it, I read the requirements, and even I have trouble figuring out what some of the rules are. You know you can't be filing a return above a certain age if you are already on somebody else's return or you are older than the taxpayer who is filing. And I mean, you look at it and I am thinking what kind of situation is that?

So I understand how these things grow, but one of the things I have asked for, and we don't have it in our legislative proposal yet is, is there a way to make the statute simpler so that people trying to make the right decision and make the right filing would be able to do it without a lot of complications?

But I do think it is an important problem, and as I have told our employees, we have to have a better story, and it is not a better story to talk about. We have to have a better story on beginning

to make a dent in the improper payment rate and in the amount of money that is being paid out.

Mr. YODER. If I might just on this topic follow up, Mr. Chairman, and I will yield back.

Is it accurate they don't have to, these applicants don't have to attest the same information that they might have to attest through a preparer? Wouldn't that be something we could clear up, clean up very easily?

Mr. KOSKINEN. That is one of the issues and that is one of the questions. Some of these things we can do on our own. Some we need legislation for, and one of the questions we are looking at is everybody sensitive, appropriately, to the burden we place on individual taxpayers—

Mr. YODER. Absolutely.

Mr. KOSKINEN [continuing]. And so we don't want to gratuitously, suddenly, make a group of people do more. But on the other hand, this is an important program. I remember when it was passed, it supports the working poor, it gives people incentives to work. It is a great program and it turns over. Part of the problem is a third of the eligible people turn over every year. They get a better job, something changes in their circumstances. So we have this irony. We have to be out trying to make sure eligible people sign up, an odd thing for tax collectors to be doing.

Mr. YODER. On that specific point—

Mr. KOSKINEN. On that point, my view is I am sensitive to the burden, we have to be careful about it. But on the other hand, we can't live with these numbers. So if it means that there is going to be a little more burden to file, and if it means the refund maybe comes a couple weeks later, so we can actually process third party information, we need to take a hard look at doing that.

Mr. YODER. I just think when a program has 20, 22, and it has been up to—I have read maybe 25 or 30 percent over the years in fraud—

Mr. KOSKINEN. It has always been—somehow magically 20–22 is the number. That is not up to the 30 percent.

Mr. YODER. Either way, that is a stunning amount of fraud, and I would think something as simple as you have to attest to certain facts before you are eligible, the same facts you would have to attest through a preparer when you fill out your form, to me seems a minimum burden to root out what is essentially a fraud that cheats and hurts every other taxpaying American who isn't cheating the system.

Mr. KOSKINEN. Not all of it is fraud. It is improper payments, to a lot of extent. It is not necessarily people consciously trying to do it. It is in fact complicated to figure out.

Mr. CRENSHAW. If we simplify the Tax Code, then we don't need to spend as much money on the IRS.

Mr. WOMACK.

#### OFFSHORE TAX NONCOMPLIANCE

Mr. WOMACK. Real quickly, what is the amount of money that the Treasury is losing to offshore tax noncompliance?

Mr. KOSKINEN. I am not sure anybody knows the answer to that.

Mr. WOMACK. What do you think it is?

Mr. KOSKINEN. We don't know—now we do know that the Voluntary Disclosure Program has flushed out 43,000 people that have paid about \$6 billion already, and obviously some of the more hard-core people are still hanging out there, figuring maybe we won't get to their country or their assets. But I have never seen an estimate as to what is out there.

My concern about it has been, or my view of why it is important, is it is important to have collected the \$5 or \$6 billion, which is a lot of money.

Mr. WOMACK. But it is more than that.

Mr. KOSKINEN. Yes, It has got to be more than that.

Mr. WOMACK. A multiple of that.

Mr. KOSKINEN. I think that is right. There are estimates that it is multiples of that. I think we need to. It rankles me when people don't pay, so I am happy, as I have said publicly, to take the unwilling to pay. Willing to pay people who have trouble, we ought to work with. We have installment agreements. There are ways we can help you try to get to be compliant if you want to be compliant. We ought to work with you.

If you are unwilling to pay, I am happy to chase you to the end of the Earth and throw you in jail, if we can, because it rankles me when you don't pay. And one of the advantages, the important signals we send with FATCA, is to the average taxpayer who is paying his taxes, he no longer has to think, "if I had a really fancy attorney and had a lot of money and a really fancy accountant I could hide my money and I wouldn't have to pay those taxes."

Mr. WOMACK. Just like those other guys do.

Mr. KOSKINEN. Just like those other guys. And so what I want the average taxpayer to feel, is if they are trying to do that, the IRS is out after them, and then we are going to be out after them too.

#### PRIVACY

Mr. WOMACK. Back in our oversight hearing in February you mentioned a couple of things that piqued my curiosity.

First, you said you that weren't at liberty to discuss personnel issues, and then second because of some union agreements you are basically forced to pay these bonuses that have already been brought up once in this hearing.

So what exactly is it that precludes you from being able to discuss with the Oversight Committee personnel issues?

Mr. KOSKINEN. Personnel issues is not just the IRS. No agency can talk, in fact no private sector company that doesn't want to get sued, can talk about personnel questions. You see it in universities all the time. That, basically, if there is an individual personnel action, privacy protections don't allow people to discuss it. Obviously you don't have privacy if you are indicted and have a public trial. But across the government, if somebody has a personnel action taken, that is a private matter.

Mr. WOMACK. Is there anything that could be done from our standpoint? You know, you were talking a minute ago about seeking approval for things like correctable errors, certain types of authority that you don't presently have. Is there something along the lines—I guess what I am getting to is doesn't it make sense that

the commissioner of the IRS should be able to be able to have a conversation with a Committee like this in the eyes of the public when there are personnel shortcomings, obvious personnel shortcomings that for a variety of reasons are just not being properly addressed?

I will leave it there.

Mr. KOSKINEN. Well, the decision has been made far beyond the IRS or this area that, in fact, personnel matters are personal, and in the private sector as well. If actions are taken against individual people, as a general matter those are held to be private, to protect the privacy of the individual.

#### WHISTLEBLOWER PROGRAM

Mr. WOMACK. Do you guys have a whistleblower program?

Mr. KOSKINEN. Pardon?

Mr. WOMACK. Do you have a whistleblower program?

Mr. KOSKINEN. We have a whistleblower program of which I am a big supporter.

Mr. WOMACK. How long has it been in place?

Mr. KOSKINEN. The whistleblower program has been there for some years.

Mr. WOMACK. Does it reward people for helping discover, expose, if you will, people that are conducting themselves improperly?

Mr. KOSKINEN. Yes, it does. But one of the complications of it is that we can't just release data. The whistleblower report just came out and it has taken awhile to aggregate enough statistics so we were not reporting, in the whistleblower report, the taxpayers that were in fact identified.

Again, taxpayer information is protected under section 6103, so when we deal with the whistleblowers, it is more complicated than it would be if we could just say. Because if somebody says General Motors has been cheating, General Motors may or may not have been cheating, and to have that out in the public domain at the front end is a problem.

But we do pay a lot of money. I am a big believer in it, primarily because when there are large complicated corporations, and if somebody is deciding to cut corners, I would like them to worry a little that there are a lot of people that know about that—lawyers, accountants, people in the finance department—and somebody might turn them in and get a big payment. That might be an incentive, and so that is why I think it is a great program.

#### IDEAL TAX RETURN

Mr. WOMACK. Finally, my last question, in a perfect world, if you were running things, king for the day, whatever you call it, although I think there are some people that think that the IRS is a monarchy, what would the ideal, and I am only talking on the individual side now—what would the ideal return look like to you?

Mr. KOSKINEN. I would preface this by saying, as I always do, tax policy is the Treasury Department, the Administration and the Congress.

Mr. WOMACK. I get that.

Mr. KOSKINEN. But having said that, the ideal return would say this is my gross income—

Mr. WOMACK. Send it to us.

Mr. KOSKINEN. Not send all of it, no, just send part of it. This is my gross income, I might say, and this is my family situation, a few deductions. I multiply it by a number and I send in a check.

Mr. WOMACK. Okay. That is kind of like flat tax. That sounds like flat tax.

Mr. KOSKINEN. Well, the problem with the flat tax is it got a bad name because people called it a flat tax. Because most flat taxes are progressive. They would say there is a 10 percent rate, a 12 percent, 14 or 18. You know, there are usually three rates. And I have always thought people who support simplification would do better not calling it a flat tax, just calling it a simple tax, because nobody would propose that the millionaire ought to pay the same amount of tax as somebody who makes \$20,000 a year.

So all of the simple tax proponents have usually said 10 percent, 16, 18, whatever you want. Somehow three always seemed to be the number. So at the bottom of my simple return you would say, "okay, I am above this, so I multiply it by 12, 16, 18 or 10," whatever it might be.

I only say that because I do think tax simplification is an important strategy, and I don't want people to think if it really got simple, it would be just a single flat tax, and then you have a whole lot of arguments, progressive or non-progressive. I think the best argument to have is by complexity and non-complexity.

Mr. WOMACK. Thank you, Mr. Chairman.

And thank you, Mr. Commissioner.

Mr. CRENSHAW. Thank you.

I think we have had most of the answers today. I have some questions I will submit for the record and Mr. Serrano may as well.

[The information follows:]



**Financial Services and General Government Subcommittee**  
**Hearing on the**  
**Internal Revenue Service FY 2015 Budget**  
**for Commissioner John A. Koskinen**

**Questions for the Record Submitted by Chairman Ander Crenshaw**

***Draft 501(c)(4) Regulation***

**Question:** How much staff time has the IRS spent reviewing comments on the draft 501(c)(4) regulation? Please provide a table by appropriation account of the cost, hours and number of people.

**Answer:** As of May 9, 2014, the estimated hours spent by attorneys and staff in the Office of Chief Counsel on the (c)(4) regulation comments are:

People	Hours	Total Cost	Appropriation
10	800 approx.	\$ 68,000 (approx.)	Enforcement

***Spending Priorities***

**Question:** Please explain why increasing the IRS travel budget by \$44 million in 2014 and by another \$58 million in 2015 is a better use of resources than the Windows 7 migration or answering the phone.

**Answer:** The IRS is vital to the functioning of government and keeping our nation and economy strong and a well trained work force is critical to fulfilling our mission of providing America's taxpayers with top quality service and to apply the tax law with integrity and fairness to all.

The IRS implemented operating guidelines in FY 2013 to reduce costs to stay within the post-sequestration, post-rescission, operating level of \$11.2 billion and to minimize the number of employee furlough days. In FY 2013, the IRS reduced travel-related expenditures of newly appropriated resources by \$56.2 million compared to the actual amount spent on travel in FY 2012. At the FY 2013 operating level, program and training travel was severely restricted and is not sustainable without seriously affecting operations. In FY 2014 the \$44 million increase will begin to restore training and program travel to levels needed to deliver critical programs in Taxpayer Service, Enforcement, and Information Technology (IT).

While Windows 7 migration and answering the phones are important needs, ensuring that employees are trained and have the resources needed to perform their duties is critical to a well-functioning operation in order for them to have the training necessary to be able to be

able to answer questions over the phone or use the more secure computers. As you know, the \$44 million for 2014 and request for \$58 million in 2015 are for training and travel. The majority of the FY 2015 request, \$48.9 million, will fund training and program travel for new initiative hires, primarily in the enforcement appropriation.

The travel resources in FY 2014 and FY 2015 will be used to:

- Conduct vulnerability assessments and program, process, internal control, site, and managerial reviews to minimize risk and evaluate and improve the efficiency and effectiveness of IRS operations;
- Provide employees with the knowledge and skills necessary to provide assistance to taxpayers, address refund fraud, and enforce the tax law with integrity and fairness; and
- Perform mission-related travel to support IT efforts to implement legislative mandates, prevent refund fraud and perform newly mandated security testing.

### ***Affordable Care Act***

For years, the IRS has asked this Committee for hundreds of millions to implement the Affordable Care Act. And for years, this Committee has not provided these increases. In fact, this Committee has either cut or flattened appropriated funds for the IRS for the past four years.

**Question:** Please tell us how and where the IRS has found the resources to implement the ACA in 2010, 2011, 2012, 2013 and 2014. Please provide a table by appropriation account, activity, FTE, and funding source.

**Answer:** Implementation of laws passed by Congress, such as the Affordable Care Act (ACA), is mandatory and therefore a priority for the IRS.

The Department of Health and Human Services (HHS) allocated administrative funding from the Health Insurance Reform Implementation Fund (HIRIF) created in the ACA. From FY 2010 through FY 2012 IRS spent a total of \$488 million from HIRIF<sup>1</sup>.

In FY 2013, ACA funding needs of \$284 million were met from a combination of base resources totaling \$129.9 million (Taxpayer Services: \$4.3M, Enforcement: \$19.3M and Operations Support: \$106.3M), multiyear carryover funds of \$84.4M and user fees allocation of \$69.7M.

Our current estimate of FY 2014 needs is \$400.6M, using a combination of base resources, user fees allocation, and HIRIF funds. The tables below provide:

1) FY 2010 – FY 2012 actuals funded from HIRIF

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<sup>1</sup> Actuals represent fiscal year end status and do not include obligation adjustments processed after the close of the year.

## 2) FY 2013 actuals and FY 2014 spend plan by account and sources of funding

ACA Actuals by Function  
FY 2010 - FY 2012

	Taxpayer Services		Enforcement		Operations Support		Total	
	\$000	FTE	\$000	FTE	\$000	FTE	\$000	FTE
<b>FY 2010</b>								
Administer New Fees on Drug Manufacturers and Health Insurers			345	1			345	1
Strengthen Oversight of Exempt Hospitals	5	0	407	3	2	0	414	3
Promoting Compliance with Other New Provisions	130	1	674	4	22	0	826	5
Program Management					122	0	122	0
Support of Implementation & Taxpayer Issues (e.g. Counsel, Appeals)	4	0	2,356	14			2,360	14
Customer Service Support (Outreach, Phones & Other Support)	1,209	9	61	1	29	0	1,299	10
Information Technology, Operations & Support & Infrastructure / Deliver New								
Tax Credits & Individual Coverage Requirement					15,340	0	15,340	0
<b>FY 2010 Total</b>	<b>\$1,348</b>	<b>10</b>	<b>\$3,843</b>	<b>23</b>	<b>\$16,515</b>	<b>0</b>	<b>\$20,706</b>	<b>33</b>
<b>FY 2011</b>								
Administer New Fees on Drug Manufacturers and Health Insurers	0		667	4	0		667	4
Strengthen Oversight of Exempt Hospitals	39	0	4,476	39	10	0	4,525	39
Promoting Compliance with Other New Provisions	373	0	11,160	89	109	1	11,642	90
Program Management	0		35	1	8,331	41	8,366	42
Support of Implementation & Taxpayer Issues (e.g. Counsel, Appeals)	96	1	4,913	30	0		5,009	31
Customer Service Support (Outreach, Phones & Other Support)	3,359	42	2,563	34	97	1	6,019	77
Information Technology, Operations & Support & Infrastructure / Deliver New								
Tax Credits & Individual Coverage Requirement	0		0		131,928	294	131,928	294
<b>FY 2011 Total</b>	<b>\$3,867</b>	<b>43</b>	<b>\$23,814</b>	<b>197</b>	<b>\$140,475</b>	<b>337</b>	<b>\$168,156</b>	<b>577</b>
<b>FY 2012</b>								
Administer New Fees on Drug Manufacturers and Health Insurers		0	1,136	8	0	0	1,136	8
Strengthen Oversight of Exempt Hospitals	168	1	3,659	34	2	0	4,029	35
Promoting Compliance with Other New Provisions	258	2	8,035	65	0	0	8,293	67
Program Management	6	0	105	0	17,798	49	17,909	49
Support of Implementation & Taxpayer Issues (e.g. Counsel, Appeals)	16	0	5,158	37	0	0	5,174	37
Customer Service Support (Outreach, Phones & Other Support)	2,291	32	2,304	32	66	0	4,711	64
Information Technology, Operations & Support & Infrastructure / Deliver New								
Tax Credits & Individual Coverage Requirement		0	0	0	257,961	407	257,961	407
<b>FY 2012 Total</b>	<b>\$2,739</b>	<b>35</b>	<b>\$20,647</b>	<b>176</b>	<b>\$276,827</b>	<b>456</b>	<b>\$299,213</b>	<b>607</b>
<b>Total FY 2010 - 2012</b>	<b>\$7,954</b>	<b>88</b>	<b>\$48,304</b>	<b>396</b>	<b>\$431,817</b>	<b>793</b>	<b>\$488,075</b>	<b>1,277</b>

Note: Source of funds in FY 2010, FY 2011, FY 2012 was HIRIF

Actuals represent fiscal year end status and do not include obligation adjustments processed after the close of the year.

## FY 2013 Actuals and FY 2014 Projected

	Taxpayer Services		Enforcement		Operations Support		Total	
	\$000	FTE	\$000	FTE	\$000	FTE	\$000	FTE
<b>FY 2013</b>								
Administer New Fees on Drug Manufacturers and Health Insurers	0	0	1,509	10	0	0	1,509	10
Promoting Compliance with Other New Provisions	211	1	9,016	71	112	1	9,339	73
Strengthen Oversight of Exempt Hospitals	34	0	3,464	30	29	0	3,527	30
Administer Adoption Credit	0	0	241	3	0	0	241	3
Support of Implementation & Taxpayer Issues (Counsel, Appeals & TAS)	46	0	5,020	32	0	0	5,066	32
Applications Development/Systems Software Contracts/Systems Testing & Delivery	0	0	0	0	248,694	446	248,694	446
Program Management, Business Design and Specifications and Oversight of Data Sharing of Federal Tax Information	125	2	18	0	11,556	58	11,819	60
Customer Service Assist Taxpayers	3,752	47	0	0	0	0	3,752	47
<b>FY 2013 Total</b>	<b>\$4,268</b>	<b>50</b>	<b>\$10,908</b>	<b>146</b>	<b>\$249,391</b>	<b>504</b>	<b>\$263,967</b>	<b>703</b>
<b>FY 2014 Projected</b>								
Administer New Fees on Drug Manufacturers and Health Insurers	0	0	2,281	17	0	0	2,281	17
Promoting Compliance with Other New Provisions	834	6	7,261	64	401	3	8,496	73
Strengthen Oversight of Exempt Hospitals	151	1	2,828	26	29	0	3,008	27
Assist Taxpayers Understanding ACA Issues	19,704	270	2,801	32	1,176	8	23,681	310
Support of Implementation & Taxpayer Issues (Counsel, Appeals & TAS)	367	3	4,861	31	0	0	5,228	34
Applications Development/Systems Software Contracts/Systems Testing & Delivery	0	0	0	0	344,511	709	344,511	709
Program Management, Business Design and Specifications and Oversight of Data Sharing of Federal Tax Information	0	0	0	0	13,366	50	13,366	50
<b>FY 2014 Projected</b>	<b>\$21,056</b>	<b>280</b>	<b>\$20,932</b>	<b>176</b>	<b>\$359,483</b>	<b>770</b>	<b>\$400,571</b>	<b>1,220</b>

FY 2014 estimated costs will be funded through a combination of base, user fees, and HIRIF resources.

**Question:** If any of the funding came from the IRS' base funding, what activities did the IRS forgo? Did the IRS answer fewer phone calls, conduct fewer audits, or prosecute fewer criminals?

**Answer:** As the data above shows, to date we have managed the demands of ACA implementation in a manner that minimizes the burden on the operating accounts to fund this legislative mandate. Because of the delayed start dates of many provisions, less than 0.7% of Taxpayer Service and Enforcement FTE will be diverted from core activities this year; and even that small share largely continues to conduct audits or answer taxpayer questions related to ACA issues.

**Question:** If the Committee does not provide the half billion that IRS is requesting for 2015 for ACA, what will the IRS do?

**Answer:** Within its budget constraints, the IRS is obligated to carry out the additional responsibilities given to it by Congress over the last several years to implement major tax-related legislation, including the ACA. The IRS conducted implementation activities in regard to this statute and those activities will continue through FY 2014 and into FY 2015 as well. The requirements for ACA activities are increasing as additional provisions of the legislation are implemented and the FY 2015 request includes the resources for the IRS to successfully implement this legislation.

If no additional funding is provided to cover the required investments to continue ACA implementation in 2015, these costs will adversely affect Taxpayer Service and Enforcement activities that have already been reduced due to sequestration and other budget cuts. Without additional Taxpayer Service resources, for instance, we estimate that the Level of Service (the number of taxpayers who receive live assistance who seek it) will decline to about 53 percent due to increased telephone demand to address ACA questions. In addition, the IRS may be forced to further reduce hours and services at numerous IRS walk-in centers throughout the United States.

### *Premium Tax Credit*

This year, the IRS began administering the very complicated premium tax credit. Anyone who chose to take the advance premium tax credit will have to reconcile the difference between their estimated and actual income when they file their return in April 2015.

**Question:** What is the IRS doing now to make sure that taxpayers understand the credit and are not hit with unexpected tax liabilities next year?

**Answer:** The best way those who are receiving advance premium tax credit payments can minimize the risk of unexpected tax liabilities next year is to keep their Health Insurance Marketplace informed of any changes in income or family size. In this regard, the IRS has been engaged in extensive outreach programs to taxpayers and tax professionals. For example, from October 2013 through March 2014, the IRS conducted over 89 outreach events, reaching over 19,800 participants from over 100 organizations, most of whom

represent many more taxpayers with whom they can share this information. The vast majority of these programs emphasized the importance of informing the Marketplace of changes in family circumstances. In addition to frequently asked questions published on the IRS website, the IRS has published Tax Tips in English and Spanish explaining the credit and the importance of keeping the Marketplace informed of family income and size changes.

This message is highlighted on the IRS.gov/aca landing page and has been featured several times on the “News” section of that page. Affordable Care Act website pages have been visited more than 2.5 million times since October 1, 2013. The IRS has produced YouTube videos in English, Spanish, and American Sign Language explaining the credit and the importance of reporting income and family changes to the Marketplace. In the social media space, tweets are being made several times each week and the IRS has posted information on the premium tax credit to tumblr.

A one-page flyer highlighting the change in circumstances message is in the final stages of production and we anticipate it will be available this summer. Additional YouTube videos are planned for this summer. We have plans to issue specific change in circumstances health care tax tips monthly throughout the summer with additional messaging in the fall. Health Care Tax Tips are posted on IRS.gov and are distributed through our e-subscription system to more than 500,000 subscribers. We routinely share information with our various federal partners and are aware that they routinely distribute and post our materials.

The IRS has sponsored, coordinated, or participated in dozens of public programs with tax professionals to make sure they have the tools they need to keep their clients informed.

**Question:** What is the estimated improper payment rate for the premium tax credit?

**Answer:** Compliance with the federal tax system is high, particularly in cases where third-party information reports are available to help taxpayers report correctly and to help IRS identify errors. Taxpayers and IRS will receive information reports from insurers and the Marketplaces, to facilitate compliance with the rules regarding the premium tax credit. IRS will use this third-party information to detect mistakes that are made on tax returns claiming the credit, before tax refunds are issued.

The IRS has responsibilities for assisting the Marketplaces in ensuring that advance premium tax credit payments are correct. First, section 1414 of Affordable Care Act directs the IRS to share certain limited tax return information to assist Marketplaces in determining eligibility. Second, the IRS has developed a calculator that Marketplaces may use to help determine the maximum permissible amount of APTC based on the Marketplace’s determination of an applicant’s income, family size, and other characteristics. Both of these services are functioning as expected and should help determine the correct amount of the APTC in the first instance.

Statute and Office of Management and Budget (OMB) guidance require a risk assessment on all programs to determine whether they are susceptible to significant improper payments.

**Question:** How will IRS determine what an acceptable improper payment rate will be?

**Answer:** As indicated in the immediately preceding answer, IRS has procedures in place to detect and prevent improper payments. In addition, the IRS will perform a risk assessment in accordance with OMB guidance on the refundable premium tax credit. Once this assessment is performed, the IRS will be in a position to evaluate the steps necessary, if any, needed to reduce improper payments.

### ***Earned Income Tax Credit***

The President's budget proposes to increase both eligibility and payments for the Earned Income Tax Credit (EITC). If enacted, the proposal would result in a revenue loss of \$81 billion and additional credit payments of \$64 billion over 10 years. This refundable tax credit can serve as a powerful incentive to either join or remain in the workforce, but suffers from a 25 percent improper payment rate and a 20 percent underutilization rate.

**Question:** When the Administration was developing this EITC expansion, did they ask IRS or did IRS get a chance to make a case for simplifying the credit calculation, making it easier to understand and easier to police?

**Answer:** The Treasury Department routinely discusses the implications of policy proposals for tax administration with IRS. As explained in the next answer, Treasury and IRS have worked together to develop a number of proposals to improve tax compliance, several of which are particularly applicable to the EITC. The Budget also includes an important proposal to simplify the EITC by simplifying the rules for claiming the EITC for taxpayers who reside with a child that they do not claim.

**Question:** Rather than complicate an already complicated credit wouldn't it make the IRS's work easier, reduce fraud, and increase usage if the credit was less complicated?

### **Answer:**

The IRS was pleased that the Bipartisan Budget Act of 2013 included its death master file and prisoner proposals to combat fraud in refundable credits.

In addition, IRS monitors Earned Income Tax Credit (EITC) improper payments and tries to bring down the error rate through a number of different approaches. The IRS currently engages in aggressive EITC enforcement, including conducting 500,000 EITC audits and is constantly improving its data analytics to target likely errors and problematic tax preparers. These measures have slowly but steadily reduced the error rate in recent years. The 2015 Budget proposes a number of additional measures that would help ensure the integrity of the EITC, as well as the rest of the tax code.

Treasury and IRS have worked together to develop a number of proposals to improve tax compliance, several of which are particularly applicable to the EITC. For example, in its FY2015 Budget the Administration proposed to generally accelerate the due date for filing information returns with the IRS (or SSA, in case of the form W-2) to January 31. Accelerating taxpayers' receipt of information returns will provide taxpayers with accurate information to prepare original returns and potentially reduce the number of amended returns filed by taxpayers. In addition, accelerating the IRS's receipt of third party information will facilitate detection of noncompliance earlier in the filing season.

In addition, the Budget includes a proposal to provide IRS greater flexibility to address certain correctable errors. Under the proposal, the IRS would be allowed to correct errors in cases where:

- The information provided by the taxpayer does not match the information contained in government databases;
- The taxpayer exceeded the lifetime limit for claiming a deduction or credit;
- The taxpayer has failed to include with his or her return documentation that is required by statute.

The Administration's Budget proposal would also simplify the rules for claiming the EITC for taxpayers who reside with a child that they do not claim.

Perhaps most important, the 2015 Budget provides adequate funding for the IRS to fulfill its enforcement responsibilities. The Budget also proposes new explicit authority for the IRS to regulate paid preparers, who prepare about 60 percent of EITC returns.

It is worth noting that improper payments in EITC occur mainly as a result of authentication errors, which include errors associated with IRS's inability to authenticate qualifying child eligibility requirements and eligibility in nontraditional and complex living situations. It is also important to recognize that a large fraction of EITC errors reflect mistakes related to the EITC's complicated qualifying child and residency rules, not fraud.

#### ***Foreign Account Tax Compliance Act - Reporting of Non-Resident Alien Tax Information***

The President's budget for fiscal year 2015 included a request to expand the United States' existing rules on non-resident alien interest income reporting to apply also to non-interest bearing accounts.

**Question:** Has the IRS conducted an economic analysis on the potential impact this proposal?

**Answer:** The proposal in the Administration's Fiscal Year 2015 Budget, *Provide Reciprocal Reporting of Information in Connection with the Implementation of the Foreign Account Tax Compliance Act* would expand the United States' existing rules on non-resident alien interest income reporting to apply also to non-interest bearing accounts. The proposal is an

important component of the United States' larger effort in recent years to combat offshore tax evasion. While the IRS has not conducted an economic analysis of the proposal, it worked with the Treasury Department in formulating the budget proposal, which is an important step in the United States' efforts to effectively implement the Internal Revenue Code provisions commonly referred to as the Foreign Account Tax Compliance Act ("FATCA").

**Question:** Has the IRS conducted a cost benefit analysis on the risk of flight of foreign capital?

**Answer:** This risk was a concern that was expressed in comment letters when the Treasury Department and the IRS issued proposed regulations under section 6049 of the Internal Revenue Code requiring U.S. banks to report bank deposit interest (in excess of \$10) earned by accountholders residing in foreign countries (76 Fed. Reg. 1105, published on January 7, 2011). The Treasury Department and the IRS carefully analyzed these concerns in connection with finalizing the regulations under section 6049, and the issues relating to the risk of flight of capital are essentially the same for the information required to be reported under the final section 6049 regulations and for the information that would be reported under the proposal in the Administration's Fiscal Year 2015 Budget, *Provide Reciprocal Reporting of Information in Connection with the Implementation of the Foreign Account Tax Compliance Act*. Addressing these concerns in the preamble to the final section 6049 regulations, the Treasury Department and the IRS described in great detail the privacy protections that are in place to safeguard all taxpayers' account information, including the fact that all of the tax treaties and tax information exchange agreements (TIEAs) to which the United States is a party contain provisions requiring that the information exchanged under the agreement be treated as confidential and protected from improper use and disclosure by both the United States and the foreign jurisdiction, and the fact that the IRS will not exchange information with a foreign jurisdiction absent confidence that it will be safeguarded in accordance with these commitments. (77 Fed. Reg. 23391-94 (April 19, 2012)).

We believe that the benefits of the Administration's budget proposal are significant. The budget proposal is a critical part of the United States' efforts to combat offshore tax evasion - a top priority of the Administration and Congress. In order to ensure that U.S. taxpayers cannot evade U.S. tax by hiding income and assets offshore, the IRS must be able to obtain information from other countries regarding income earned and assets held in those countries by U.S. taxpayers. Obtaining such information requires the cooperation of foreign governments, which, in turn, often requires the United States to be able to provide information about nonresident accounts held in U.S. financial institutions.

### ***Foreign Account Tax Compliance Act - Strategy***

Implementation of FATCA started in 2010 and will continue through 2017, but final regulations for FATCA were published in January 2013.

**Question:** Has IRS completed its FATCA Program Compliance Strategy?



**Answer:** The IRS completed a preliminary FATCA Program Compliance Strategy in 2013, and work continues to revise and extend that strategy to take into account the provisions of additional regulations and other interpretive guidance published over the course of 2014. .

**Question:** Does the Strategy address the National Taxpayer Advocate’s four recommendations from her 2013 report to Congress that the IRS:

1. Undertake proactive steps to preserve the due process rights of taxpayers, by issuing FATCA specific guidance for reasonable cause or similar relief, which adopts a measured approach to the imposition of penalties with respect to benign non-filers;
2. Ensure that U.S. taxpayers and non-residents have at their disposal a timely and effective mechanism for addressing information reporting errors of FFIIs;
3. Act responsively and expeditiously to implement recommendations of stakeholders that have particular expertise on the effective implementation of FATCA; and
4. Take immediate steps to eliminate or reduce duplication between the Form 8938 and the FBAR form?

**Answer:** The IRS has considered the NTA’s report in developing our FATCA Program Compliance Strategy, and the NTA’s four recommendations are addressed below:

1. Certain individuals holding an interest in a foreign bank account or another specified foreign financial asset are required under section 6038D of the Internal Revenue Code to report information about such accounts and assets to the IRS annually. Reporting is required on Form 8938, which must be attached to the taxpayer’s Federal income tax return filed for the year. In developing the regulations for section 6038D, the IRS sought to balance the reporting burdens on taxpayers against the tax compliance goals of Congress in enacting the new reporting and penalty provisions. The regulations provide significant relief from reporting burdens by (i) removing many individuals from the reporting requirements altogether, (ii) providing exceptions that relieve taxpayers from reporting certain assets, and (iii) providing special valuation rules to simplify valuing certain assets. Although failure to file a required Form 8938 may result in penalties, section 6038D contains a “reasonable cause” exception. Under this exception, no penalty will be imposed on any failure to report if it can be shown that such failure is due to reasonable cause and not due to willful neglect. The regulations provide that all pertinent facts and circumstances will be taken into account in determining whether the reasonable cause exception applies. See section 1. 6038D-8T(e) of the regulations.

Because experience under the new FATCA reporting requirements is still in the early stages, detailed FATCA-specific guidance on reasonable cause relief does not yet exist. However, there are clear general standards in the Internal Revenue Manual addressing the approach that IRS employees must take whenever considering the applicability of a reasonable cause exception to a civil penalty. The general reasonable cause standards are set out in the IRS’s “Penalty Handbook”, which is included in the IRM at section 20.1. The Handbook sets forth general policy and

procedural requirements for assessing and abating penalties, as well as the criteria for relief from certain penalties.

The reasonable cause instructions set forth in the Penalty Handbook provide a sound foundation for fair and uniform application of the new FATCA-related penalties. The IRS will consider options for providing more certainty to taxpayers affected by the new FATCA requirements as more data is collected on specific factors might be relevant in making reasonable cause determinations under FATCA.

2. The IRS has general procedures to allow U.S. taxpayers and non-residents to provide information that corrects information received from another source. We expect that these procedures will be used by taxpayers to make corrections to information received under FATCA. In addition, U.S. taxpayers and non-residents may well want to contact their financial institution upon learning that information provided to the IRS by the institution is in error. The IRS is always willing to work with financial intermediaries to correct erroneous information reports.
3. The IRS has already responded to extensive comments on FATCA implementation by taking these comments into account in developing applicable guidance and procedures.

Guidance: Since FATCA's enactment in 2010, the IRS has actively sought the input of all affected parties. In the development of guidance, the Treasury Department, the IRS Office of Chief Counsel, and the IRS Large Business and International (LBI) division, have requested and received extensive written comments from hundreds of individuals, financial institutions, and their representatives over several iterative cycles of guidance development. In addition, government personnel have participated in dozens of conferences and meetings to continually exchange views with those affected by the legislation, their advisors, and other knowledgeable stakeholders. All views submitted have been carefully considered, and dozens of changes have been incorporated to reflect suggestions for reducing burdens and addressing industry concerns. Guidance has been provided as expeditiously as feasible, consistent with effective implementation of the law, including (i) three detailed notices issued between 2010 and 2011; (ii) comprehensive proposed regulations issued in February 2012; (iii) final regulations issued in January 2013; (iv) correcting amendments issued in September 2013; (v) a draft financial institution agreement and highlights of upcoming changes issued in October 2013; (vi) a final financial institution agreement issued in January 2014; and (vii) extensive additional regulations issued in February 2014 containing clarifications to the previously issued final regulations, as well as guidance to coordinate FATCA with preexisting account due diligence, reporting, and withholding requirements under other provisions in the Internal Revenue Code.

In addition, to facilitate an orderly transition for withholding agent and FFI compliance with FATCA's requirements and in response to stakeholder comments, the IRS and the Treasury Department issued guidance in April 2014 (Notice 2014-33)

announcing that calendar years 2014 and 2015 will be regarded as a transition period for purposes of IRS enforcement and administration of the due diligence, reporting, and withholding provisions under FATCA. During this transition period, the IRS will take into account the extent to which withholding agents and others with new due diligence, reporting or withholding requirements under FATCA have made good faith efforts to comply with these requirements.

Forms and publications: The IRS has worked with its Information Reporting Program Advisory Committee, as well as with many other stakeholders, to incorporate suggestions into new and revised forms and instructions to reflect FATCA provisions. In addition, in response to inquiries from stakeholders, the IRS has posted to [irs.gov](http://irs.gov) FATCA alerts and notices to provide as much information about FATCA compliance as possible.

FFI registration: Recognizing the logistical complexities that Foreign Financial Institutions (FFIs) faced in registering for FATCA and obtaining the required Global Intermediary Identification Number (GIIN), the IRS developed a process through which stakeholders may submit their FATCA questions via the IRS's FATCA webpage. Submitted questions are reviewed by a cross-divisional team of subject-matter experts. Questions that are asked frequently and/or address significant issues are routed to the appropriate business/functional unit for further consideration. To the extent that available resources allow, answers are developed, reviewed, and posted to the IRS's FATCA webpage to benefit all stakeholders.

In addition, the IRS incorporated stakeholder input in the design of the registration process and FFI registration portal. Specifically, feedback from internal and external stakeholders was used in the design of current and future portal functionality, including but not limited to input screens, FFI list search and download tool, and FFI message board status and description of required actions.

Form 8938 filer issues and feedback: Since 2012, the IRS has monitored communications with taxpayers concerning Form 8938 filing issues, and has updated and enhanced communication channels, such as Frequently Asked Questions (FAQs) and self-help documents on [irs.gov](http://irs.gov), to address emerging taxpayer issues. For example, IRS staff listened to recordings of taxpayer calls to IRS Accounts Management assistants and evaluated email and other electronic feedback to the IRS to identify and address emerging issues concerning Form 8938. Further, the IRS has attempted to address concerns received by U.S. embassies from U.S. taxpayers and others concerning FATCA. Additionally, IRS executives and staff have held numerous in-person meetings with tax and financial industry representatives to discuss taxpayer concerns.

4. Congress enacted both the Title 31 and the Title 26 provisions regarding the reporting requirements of the FBAR (formerly Form TD F 90-2-1, Report of Foreign Bank and

Financial Accounts, now FinCEN Form 114) and Form 8938 (Statement of Specified Foreign Financial Assets). Reporting on the FBAR is required for law enforcement purposes under the Bank Secrecy Act, as well as for purposes of tax administration. As a consequence, different policy considerations apply to Form 8938 and FBAR reporting. These are reflected in the different categories of persons required to file Form 8938 and the FBAR, the different filing thresholds for Form 8938 and FBAR reporting, and the different assets (and accompanying information) required to be reported on each form. Although certain information may be reported on both Form 8938 and the FBAR, the information required by the forms is not identical in all cases, and reflects the different rules, key definitions (for example, “financial account”), and reporting requirements applicable to Form 8938 and FBAR reporting.

The IRS is committed to minimizing taxpayer reporting burdens to the extent consistent with the effective implementation of FATCA, and this commitment is incorporated in the regulations implementing Code section 6038D. For example, the statute excludes from the definition of “specified foreign financial assets” that must be reported on Form 8938 any financial accounts of taxpayers maintained by financial institutions that are U.S. entities (or U.S. territory entities). Thus, taxpayers holding foreign securities in U.S. brokerage accounts are not required to report the foreign securities held in such accounts on a Form 8938. The regulations importantly extend this reporting relief to financial accounts of U.S. taxpayers maintained by controlled foreign corporation subsidiaries of U.S. financial institutions, a particularly important burden reduction for U.S. taxpayers living abroad. This exclusion is fully consistent with the goals of FATCA, because these FFIs, like their affiliated U.S. financial institutions, have annual 1099 reporting obligations with respect to such accounts under Chapter 61, greatly reducing the potential for offshore tax evasion by their account holders.

The section 6038D regulations carefully tailor the new reporting requirements to compliance risks in additional ways. Most significantly, the regulations attempt to strike an appropriate balance between reporting burdens and compliance benefits by limiting filing requirements to those individuals with specified foreign financial assets totaling above stated minimum dollar thresholds (e.g., \$50,000 for single taxpayers resident in the U.S.). Recognizing that an individual residing outside the United States can reasonably be expected to have a greater amount of specified foreign financial assets for reasons unrelated to the policies underlying section 6038D, the regulations substantially increase the reporting thresholds for U.S. persons residing abroad. In addition, the regulations provide that certain specified foreign financial assets that are timely reported to the IRS by the taxpayer on certain other IRS forms are not required to be separately reported on Form 8938, provided that the number of these other forms is disclosed on Form 8938. Further, proposed rules that would impose reporting requirements on certain domestic entities that could be used by U.S. individuals to evade required reporting have been carefully targeted to reach only those entities presenting the most significant tax compliance risks, and these rules

will apply prospectively only to the extent they are issued as final regulations after analysis of all stakeholder comments.

In the measured implementation of section 6038D, the Treasury Department and the IRS have strived to fully accomplish the congressional objective of stemming offshore tax evasion while minimizing taxpayer reporting burdens. As the IRS gains experience from the FATCA reporting on offshore accounts of U.S. persons received from both the account holders and the foreign financial institutions maintaining those accounts (or from their governments, in the case of financial institutions in countries with Model 1 intergovernmental agreements with the United States), the IRS will continue to place a high priority on minimizing reporting burdens consistent with achieving the tax compliance objectives of FATCA.

With respect to the FBAR, while FinCEN has delegated substantial enforcement responsibilities to the IRS, IRS authority does not extend to rulemaking. FinCEN retains sole authority to amend the Title 31 regulations implementing the FBAR filing regime and setting out many of the key filing requirements. Moreover, FinCEN now controls the new FBAR form and its instructions, and FinCEN solely manages the electronic filing process for FBARs.

#### *Foreign Account Tax Compliance Act – Cost Estimate*

**Question:** Please provide a comprehensive program-wide cost estimate for FATCA implementation. Please include a table by appropriation account of funds and FTE for 2010-2017.

**Answer:** Please see the table inserted on the next page. Although the data requests information for FY 2010, we had no expenditures that year because the law was not enacted until March 2010. We cannot provide information for FY 2016 or 2017, as those figures are still being developed.

Program	New Discretionary									
	Appropriated Resources Only					Budget Request				
	FY 2011 Actuals \$000	FTE	FY 2012 Actuals \$000	FTE	FY 2013 Actuals \$000	FTE	FY 2014 Enacted \$000	FTE	FY 2015 Budget Request \$000	FTE
Base	897	1	6,690	20	11,806	40	52,976	61	52,772	380
Implement FATCA (Enforcement portion)			1,883	3	6,900	12	6,400	23	20,613	138
Implement FATCA (Enforcement portion)-New in FY 15									24,433	204
Implement FATCA (IT portion)	897	1	4,807	17	4,906	28	46,576	38	7,726	38
FY 15 Cap Adjustment Increase									32,223	140
Implement IT Changes to Deliver FATCA									32,223	140
<b>TOTAL</b>	<b>\$897</b>	<b>1</b>	<b>\$6,690</b>	<b>20</b>	<b>\$11,806</b>	<b>40</b>	<b>\$52,976</b>	<b>61</b>	<b>\$84,995</b>	<b>520</b>

1The enforcement portion of the FATCA initiative will be funded with FY 2015 enforcement base resources.

*Foreign Account Tax Compliance Act – Data Usage and Performance Measures*

In 2012, GAO observed that IRS “has not developed a timeline for using this information to improve tax compliance... Without a timeline to help it manage implementation, it is less certain that IRS will be prepared to use the FATCA information timely and effectively.” (GAO -12-484).

**Question:** Has IRS developed a timeline to develop a strategy on how it will use FATCA data? If not, please provide an estimated completion date.

**Answer:** As discussed above, the IRS completed a preliminary FATCA Program Compliance Strategy, which included a tentative timeline, in 2013. Additionally, more detailed work has commenced to revise and extend that strategy to reflect the provisions of regulations and other interpretive guidance published over the course of 2014, as well as developments pertaining to data format and transmission mode and the expected availability and accessibility of the data to be received in March and September 2015 pursuant to the developing network of intergovernmental agreements. We expect that a complete compliance strategy will be developed in 2014 and refined in early 2015.

**Question:** Has IRS developed performance measures for its FATCA program? If not, please provide an estimated completion date.

**Answer:** Performance measures are being developed incrementally as FATCA projects are deployed. The first project deployed was the FATCA Foreign Financial Institution (FFI) Registration System, and measures are in place for registrations, such as volumes by country and status. As projects continue to roll out, the IRS will develop and implement additional performance measures.

*User Fees*

The IRS has the authority to collect and spend user fees. These are funds that are available to the IRS outside of the appropriations process. In fiscal year 2013, the IRS had more than \$600 million in available fee income and ended the year with nearly \$300 million in unobligated balances.

**Question:** Please tell us how IRS decides to use these fees.

**Answer:** The IRS determines the use of user fees based on agency-wide requirements given the total IRS funding availability.

User fees collected for the preparer tax identification number and photocopier program can only be used for managing these specific programs. These programs do not receive congressional appropriations and must recover all costs for providing the service through fee collections.

**Question:** Is IRS spending user fees to fund Affordable Care Act requirements? If so, how much in each fiscal year between 2010-2015?

**Answer:** For FYs 2010 through 2012, IRS did not spend user fees on implementing ACA requirements. In FY 2013, IRS spent \$69.7M. In FY 2014, IRS plans to spend up to \$188.2M in user fees on ACA. The FY 2015 President's Budget requests the resources necessary to fund ACA.

**Question:** Could IRS spend user fees on improving customer service, answering more phone calls, or conducting more audits?

**Answer:** The IRS has used user fee revenue to provide improved customer service since FY 2007, with the bulk of the revenue going toward answering more phone calls. In FY 2007 budget reductions were made to Taxpayer Services and Operations Support accounts with an understanding that base funding levels for these accounts would be maintained by allocating user fee funds. Since 2007, the IRS has consistently allocated user fees to base funds. This accounts for approximately \$173.3M of the user fee budget requested each year for the delivery of customer service, including answering telephone calls.

### ***Bonuses***

**Question:** When the IRS gives out bonuses and performance awards, does it take employee conduct into account? Are bonuses and awards conditional upon uphold and adhering to IRS standards of ethics and conduct? Should they be?

**Answer:** Executives and senior level employees are covered by our policy that states they are ineligible for a monetary performance-based award for the rating period during which a disciplinary action or adverse action is administered. We are in negotiations with the National Treasury Employees Union to establish a similar policy for our bargaining-unit workforce as well as a policy for all other employees.

**Question:** If an employee violates 6103, but processes enough returns at a fast enough rate, would they still get a performance award?

**Answer:** The penalty imposed by the IRS for violating IRC Section 6103 varies depending on the severity of the violation, the history of employee conduct issues, and the facts and circumstances surrounding the incident. The penalty imposed by the Internal Revenue Code for the intentional disclosure of tax or other personally identifiable information to unauthorized persons is removal from employment. The penalty imposed by the IRS for disclosure due to carelessness, recklessness, or negligence is a reprimand, suspension or removal, and the penalty for accessing taxpayer tax or other personally identifiable information, beyond authorized levels, could result in a suspension or removal.



**Question:** Is getting the work done more important than how the work is done?

**Answer:** No. When assessing employee performance, the IRS uses a balanced measurement system that is consistent with its mission and goals. It is comprised of three components: customer satisfaction, employee satisfaction, and business results. Each is an important element and is considered by the IRS when setting organizational objectives, establishing goals, assessing progress and results, and evaluating individual performance. The system was specifically designed to balance the results achieved with the actions used to achieve them. For example, numerical results will never equate directly to a particular rating on an employee's evaluation. Rather, each of the balanced measures is taken into account and given due consideration when determining the rating.

**Question:** The omnibus required a report from the IRS about bonuses. IRS provided a partial response in February. When can the Committee expect the rest of the report?

**Answer:** At this time, the IRS is unable to provide the information for FY 2015, as the FY 2015 appropriations bill has not yet been enacted.. I am happy to update you once that information is available.

#### ***Budgetary Effect of Hiring Freeze***

**Question:** In FY 2011, the IRS implemented a hiring freeze. As a result of this hiring freeze, how much in labor and non-labor costs have been reduced? Please provide a table showing the reduced costs by fiscal year (2011-2015) and by account.

**Answer:** The table below provides estimates of labor savings resulting from the IRS's exception hiring policy.

<b>Labor Savings Estimates from Reduced Staffing</b> <b>12/19/2010 - 9/30/2014 Excluding Seasonal Employees</b> <b>(In Thousands)</b>				
	2011 - Estimate	2012 - Estimate	2013 - Estimate	2014 - Projected
<b>Taxpayer Services</b>				
Labor	(30,756)	(34,492)	0	(33,000)
<b>Enforcement</b>				
Labor	(66,749)	(118,567)	(123,742)	(128,000)
<b>Operations Support &amp; BSM</b>				
Labor	8,979	(35,676)	(11,879)	(3,000)
<b>Total Labor</b>	<b>(88,527)</b>	<b>(188,734)</b>	<b>(135,621)</b>	<b>(164,000)</b>
All estimates are based on average staffing costs.				
1 Start of FY 2011 is PP 26 (12/19/2010) the first full pay period of the hiring freeze				
2 End of FY 2014 staffing level is based on projected staffing changes				

With an overall budget reduction of more than \$850 million since FY 2010, The IRS has initiated many cost savings efforts. Specific actions that the IRS has taken to achieve greater cost savings and efficiencies fall into several major areas. Some examples of the ways that the IRS is achieving cost savings include the following:

In FY 2011, a hiring freeze started that continues today with exceptions made on a limited basis. Since FY 2010 prior to the implementation of this freeze, full-time permanent staffing has declined by more than 10,000 or 12 percent. Compared to FY 2010, FY 2013 labor expenditures have declined by more than \$400 million (4.9%).

The table below provides estimates of non-labor savings resulting from the IRS's cost reduction efforts.

<b>Non-labor Spending Comparison</b>			
	2011	2012	2013
<b>Taxpayer Services</b>			
Non-Labor	(25,107)	(1,696)	(29,627)
<b>Enforcement</b>			
Non-Labor	(90,397)	(52,991)	(81,663)
<b>Operations Support</b>			
Non-Labor	(68,735)	(145,471)	(7,480)
<b>BSM</b>			
Non-Labor	(35,328)	61,417	(72,473)
<b>Total Savings</b>	<b>(219,567)</b>	<b>(138,741)</b>	<b>(191,242)</b>

The IRS has also implemented significant reductions in its non-labor spending. During the last three years, the IRS has limited employee travel and training to mission-critical projects. By our estimates, training costs have been reduced by 83 percent and training-related travel costs have been reduced by 87 percent from FY 2010 through FY 2013. We have expanded the use of alternative delivery methods for in-person meetings, training, conferences, and operational travel.

Also, in FY 2011, the IRS eliminated the practice of mailing tax form packages to taxpayers at the beginning of the filing season. Taxpayers are directed to IRS.gov for the tax forms they need. Also, the IRS workforce is migrating to paperless Earnings and Leave Statements. These steps have contributed to a reduction of approximately \$45 million in postage costs since FY 2010 on top of the \$9 million reduction in printing costs captured in the Campaign to Cut Waste.

In May 2012, the IRS announced a sweeping office space and rent reduction initiative that over two years is projected to close 43 smaller IRS offices and consolidate space in many larger facilities. These measures will reduce rent costs by more than \$40 million and reduce total IRS office space by more than 1.3 million square feet by the end of FY 2014. This was on top of reductions of 2.8 million square feet from FY 2003-11. In FY

2014, IRS expects to release another 350 thousand square feet, for additional savings; however, our ability to release space is constrained by current resources. The IRS has partnered with the National Treasury Employees Union to find innovative ways to do more with existing space, such as developing new workspace standards to decrease individual office size, and has offered its employees increased telework opportunities.

### *Level of Service*

**Question:** What toll-free assistor level of service, expressed as a percentage, would the IRS have been able to provide at the pre-sequester level of funding of \$11.8 billion?

**Answer:** At the pre-sequestration level, IRS projected it could have delivered a 68% Level of Service (LOS) this year, seven points higher than the current projection of 61%. This improved level of service would have resulted in being able to answer roughly three million additional taxpayer calls.

**Question:** How many individual return examinations, expressed as a number and percentage of coverage, would the IRS have been able to provide at the pre-sequester level of funding of \$11.8 billion?

**Answer:** At the pre-sequestration level, IRS would have been able to close 100,000 additional individual examinations. These additional closures would increase coverage from the projected 0.8% to 0.9%. Though the IRS cannot provide a breakdown of additional collections from individual audits, the IRS estimates that it would have returned to the Federal government over \$2 billion more in collections had it received the remaining \$500 million that the budget was cut as a result of the sequester.

**Question:** How much does it cost the IRS to improve toll-free assistor level of service measure by one percentage? If there are diminishing marginal returns, then identify the points at which the cost of each percentage increases.

**Answer:** Within its historical range of performance (from 60 to 80%), IRS estimates it costs roughly \$8 to \$10 million to increase LOS by one percentage point. While marginal returns will diminish slightly across this range (as the number of repeat call attempts declines), the marginal return is not expected to diminish significantly until LOS exceeds 80%.

### *Free File Alliance Memorandum of Understanding*

The current five year Free File Memorandum of Understanding expires in October of 2014.

**Question:** What is the current status of the renewal negotiations with the Free File Alliance?

See below

The Committee has heard that IRS and the Free File Incorporated (FFI) (formerly the Free File Alliance) have agreed to a one year extension.

**Question:** Why has the IRS only offered a one year renewal?

See below

**Question:** What makes this negotiation with the Free File Alliance different from the first two Memorandums of Understanding that were both negotiated for five year terms?

**Answer:** In February 2014, IRS leadership met with the leaders of the Free File Incorporated (FFI), formerly known as the Free File Alliance, to discuss a one-year extension of the expiring Memorandum of Understanding (MOU). The extension was announced on May 21, 2014 and is valid from October 30, 2014 to October 30, 2015.

The extension agreement includes specific language that a full renegotiation of the five year Agreement/MOU will begin in June 2014 with a goal to conclude those negotiations by December 2014. IRS and FFI plan to enter into a multi-year amendment to the agreement before the expiration of the one year extension on October 30, 2015. Free File has played a key role in IRS' strategy for growing e-file. The one-year extension provides the IRS and FFI time to shape a longer term agreement to include innovations to the twelve year old Free File program in order to grow e-file, improve quality and reduce taxpayer burden.

### **Questions for the Record Submitted by Congressman Mario Diaz-Balart**

#### ***FATCA***

**Question:** In your opinion, how ready are you to implement FATCA?

**Answer:** We are currently on target to implement FATCA, and significant progress has already been made. The new Form 8938 (Statement of Specified Foreign Financial Assets) is being filed by taxpayers, analysis on the filing population has been conducted, and customer service processes and documents are in place. The FFI Registration System was deployed last summer. Global Intermediary Identification Numbers (GFINs) are being issued, and the IRS FFI List and Search tool is on target for deployment in June 2014. In addition, in 2013, the IRS and Treasury issued final chapter 4 regulations and, in 2014, the IRS and Treasury issued temporary regulations under chapters 3, 4, and 61, and section 3406 (including temporary regulations to coordinate the regulations under chapters 3 and 4, and section 3406, with the requirements provided in the final and temporary chapter 4 regulations), as well as other guidance. The IRS has published updated final versions of all forms and certain instructions to incorporate the documentation requirements of chapter 4. We are currently developing release 1 of an International Compliance Management Model (ICMM) to receive and process FATCA

data, and we are on target to deploy initial functionality to receive and process pooled reporting from Model 2 IGA jurisdictions in January 2015, which will be followed by deployment of full functionality for receiving and processing all incoming FATCA account reports (including those from IGA jurisdictions), along with capturing the data from the Form 8938 and the Form 1042-S. A new International Data Exchange Service (IDES) for transmission of FATCA data is under development and so far is on target for a January 2015 deployment.

**Question:** Do you expect US financial institutions to be able to have the necessary systems and procedures ready for the July 1st implementation date, given that the necessary forms have not been issued and all the IGAs have not been signed by the Treasury?

**Answer:** Yes. The IRS and Treasury have been engaged since the inception of the FATCA implementation effort in continual dialogue with U.S. financial institutions and other domestic and international stakeholders on a wide array of FATCA implementation issues, including system and process development and readiness. With the benefit of feedback obtained through this dialogue, the IRS and Treasury have eased burdens on U.S. financial institutions seeking to comply with FATCA in several significant ways. For example, the final chapter 4 regulations issued in 2013 reduced potential burdens associated with complying with the FATCA statute. Following the publication of the final chapter 4 regulations, the IRS and Treasury issued Notice 2013-43 to preview, among other things, a revised timeline for implementation of the FATCA requirements. In February of this year, the IRS and Treasury issued temporary regulations under chapter 4 that clarify and modify certain provisions of the final chapter 4 regulations, including incorporating the revised timeline for the implementation of FATCA set forth in Notice 2013-43, and temporary regulations under chapters 3 and 61, and section 3406, that coordinate those regulations with the due diligence, reporting, and withholding requirements provided in the final and temporary chapter 4 regulations. Additionally, in April, the IRS and Treasury published Announcement 2014-17 providing that jurisdictions that, before July 1, 2014, have reached agreements in substance with the United States on the terms of an IGA and **that** have consented to be included on the Treasury and IRS lists of such jurisdictions would be treated as having agreements in effect until the end of 2014. Most recently, in early May, the IRS and Treasury issued Notice 2014-33 providing that calendar year 2014 and 2015 would be regarded as a transition period for purposes of IRS enforcement and administration with respect to the implementation of FATCA by US and foreign financial institutions and other entities with FATCA responsibilities. The guidance issued in May also announced the intention of the IRS and Treasury to provide further relief by amending regulations to provide that an obligation held by an entity that is issued, opened, or executed on or after July 1, 2014, and before January 1, 2015, will generally be treated as a preexisting obligation for purposes of implementing the applicable due diligence, withholding, and reporting requirements under chapter 4. Financial institutions in a jurisdiction entering into an IGA can also apply this guidance. The IRS has also pre-released drafts of key FATCA forms in order to give U.S. financial institutions as much time as possible to begin developing systems and procedures in advance of July 1, 2014 and, by early May, had published

updated final versions of all forms and certain instructions to incorporate the documentation requirements of chapter 4.

### ***Money Market Mutual Fund Reform***

As you may know, the Securities and Exchange Commission has been working on finalizing a proposal on money market mutual fund reform. The proposal includes the option to require prime money market funds to change the pricing from a stable net asset value (\$1 in equal \$1 out) to a floating net asset value. Now, the fluctuations in value are very, very miniscule because the nature of the underlying fund securities are short term and very safe.

A major obstacle to making the floating NAV work for money market funds is the tax complication it would create for investors, particularly large corporate investors that use money market funds as a cash management tool and constantly move money in and out of these funds throughout the day. Ultimately, it would create very miniscule capital gains/losses for investors. And while the IRS has already proposed relief on wash sale rule, it doesn't address the issue when the buy/sale occurs outside the wash sale parameters. SEC Chair Mary Jo White recently indicated that SEC staff has been working with the IRS staff on addressing the tax issue.

**Question:** Can you describe where you are in the process in fixing this issue with the SEC?

**Answer:**

The Treasury Department (including the IRS) has analyzed the tax compliance implications of the proposed change to a floating NAV for money market funds. A few weeks after the SEC proposed new money market fund regulations last summer, the IRS proposed *de minimis* relief from the wash sale rules. Public comment on this proposed relief and on the SEC proposals, however, requested additional simplification. If the SEC adopts the floating NAV in its final regulations, we expect that we will, as appropriate, issue guidance for taxpayers in a timely fashion.

**Question:** Can you make all of the necessary changes using your administrative power or do you need a legislative change?

**Answer:**

The Treasury Department and the IRS have been considering guidance to provide additional simplification within our current administrative power. However, we are always happy to work with Members on legislative provisions that would improve the administration and functioning of the Tax Code.

**Question:** Will the potential changes be transparent to the public and subject to notice and comment? Is it subject to cost-benefit analysis?

**Answer:** While it would be premature to comment specifically on the form of hypothetical guidance that has not been issued, as a general matter, when the guidance takes the form of regulations, we provide notice and seek comment. In addition, in this case, we issued a notice in the Internal Revenue Bulletin containing a draft revenue procedure providing wash sale relief on which we sought comments. Those comments are being considered in preparing any final guidance. This notice-and-comment process helps ensure that guidance issued is fair and minimally burdensome. We always strive to reduce burden, and with simplification as the primary goal, we expect any guidance in this area to actually reduce overall burden.

Mr. CRENSHAW. One thing I would remind you, we asked in the February hearing there were some requests made for the record for some information that is still forthcoming. So I just want to remind you of that.

Mr. KOSKINEN. I am unhappy about that. My view is we ought to be responsive and try to get back to you as quickly as we can. Again, those answers are prepared. Some other people are involved, you know, as the normal process, every agency goes through. Treasury gets to look at it and then OMB gets to look at them and they always end up not getting changed very much.

But it is a process. But all I can tell you is that I don't think the response time is appropriate. We ought to get back to you quickly. And if you will send me these questions, I commit to you I will do the best we can to get you answers quickly.

Mr. CRENSHAW. We appreciate that, and we know you have a tough job, I think, ultimately, to restore the confidence and credibility of the IRS, and so we want to work with you anyway we can to make that happen.

Thank you for being here today. This meeting is adjourned.



TUESDAY, APRIL 29, 2014.

**DEPARTMENT OF THE TREASURY**

**WITNESS**

**HON. JACK LEW, SECRETARY**

Mr. CRENSHAW. Good morning. The hearing will come to order. Welcome members of the Subcommittee and to our witness Jack Lew from the Department of the Treasury. Mr. Secretary, glad you are here to consider the President's 2015 budget request. We also welcome yesterday's announcement about the many new Treasury sanctions against individuals and businesses undermining Ukraine's stability and sovereignty. We expect the Department to use its powers both fully and forcefully against those who threaten Ukraine's security.

Mr. Secretary, I know you are pleased that the deficit dropped to 4.1 percent of the GDP last year, but the deficit is still the highest it has ever been both in real and constant dollars other than the four past consecutive deficits that exceeded \$1 trillion under this Administration. That string of \$1 trillion deficits is why the gross Federal debt last year exceeded 100 percent of the GDP and will remain there, it looks like, for the rest of this Administration. I doubt that you or the President should be pleased about this legacy.

When we look at the mandatory spending in the President's budget, it is estimated to grow from \$2.5 trillion in the fiscal year 2014 to \$3.6 trillion by the fiscal year 2019. By then, the gross interest payments on the debt alone will exceed \$750 billion which will dwarf our defense spending. And because of that, it troubles me, and I wonder why the Administration didn't propose any serious entitlement reforms to prevent further intergenerational inequality.

And so I hope that you will work with the Budget Committees and the authorizing Committees to give the next generation the opportunity to forge their own way forward rather than saddle them with the debts of their grandparents and their parents. As a member of the Appropriations Committee, we have driven down discretionary spending every year since fiscal year 2011, and I am a little concerned that more progress has not been made on the mandatory side of the ledger.

The Department's own budget request also raises some questions. The request seeks to add more than \$1 billion to the IRS; it seeks to authorize language to pay certain IRS employees bigger salaries and bonuses than are allowed under the civil service system. It seeks to eliminate language enacted in the omnibus to prohibit the IRS from targeting groups for additional scrutiny based on their ideological beliefs and to prohibit the IRS from targeting

citizens of the United States for exercising any right guaranteed under the First Amendment. It also seeks to eliminate language requiring the videos produced by the IRS to be appropriately reviewed. Requesting \$1 billion more, eliminating prohibitions against targeting that were negotiated by this Committee, and proposing a new rule for the 501(c)(4)s before investigations by Congress and the Department of Justice had been completed will not build trust in the IRS, the Department of the Treasury, the Federal government, or overall government.

So I think that if you were to explain how the inappropriate criteria came into use, how they were allowed to be used for years, that's what we need to bring back some trust in the IRS and make sure the IRS can administer the tax code in an impartial and non-partisan manner.

Similar to the Department's 2012, 2013, and 2014 budget requests, the Department is seeking discretionary spending for the IRS above the spending caps by relying on discretionary cap adjustments that are not part of current law. Absent a change to either the Budget Control Act or the Ryan-Murray agreement, \$480 million of the IRS request is both pointless and meaningless. If the \$480 million is of importance to the Administration, then the President would have found a way to pay for it from the \$1.14 trillion allowable under the Ryan-Murray rather than use a gimmick that the Budget Committees have rejected for the past three years.

In addition, I am interested to hear from you today an update on the final regulations to implement the Foreign Account Tax Compliance Act which will take place on July 1 of this year. The so-called FATCA has profound and far-reaching impact on U.S.-based companies as well as foreign companies with assets in the United States or clients. And I am concerned with the amount of time that's going to be available to comply with these regulations when the final rules were not released until the end of February. That's going to give a lot of the global companies less than five months to comply. But again I want to thank Secretary Lew for being here today and I would like now to turn to the Ranking Member, Mr. Serrano, for his comments.

Mr. SERRANO. Thank you Mr. Chairman. I would like to join you in welcoming Secretary Lew before the Subcommittee for the second time. You lead a department with a variety of missions important to our economy, our government, and our nation as a whole. The Treasury Department plays a central role in promoting economic growth and opportunity through programs like the CDFI Fund, ensuring financial stability through the implementation of Dodd-Frank, enforcing our tax laws fairly, and managing our nation's finances. Your budget request for fiscal year 2015 promotes all of these things. Most of the agency is held to pretty austere budget levels, but there are significant requested investments at the IRS which is the largest part of your budget. And those requested increases are much needed.

As I said at our hearing on the IRS a few weeks ago, almost \$1 billion has been cut from their budget over the past four fiscal years, and we should not be surprised that the result is we do less service and an increased tax gap. Since that hearing we have even more evidence of the negative impact that these budget cuts are

having on the IRS. A recent GAO report found that the budget cuts to the IRS instituted over the last few years had resulted in reduced enforcement and reduced taxpayer services. This comes on top of reports the IRS audit rates are at their lowest levels since the 1980s. As it currently stands, these cuts have had the perverse effect of promoting noncompliance for those who want to cheat the system while at the same deterring people who want to file their taxes correctly from getting their questions answered. Your budget request for the IRS attempts to reinvest in the agency restore those losses, and reverse these wrong-headed incentives.

On a different topic I am a strong supporter of the Community Development Financial Institutions Fund, which has help promote economic investment in traditionally underserved areas. I understand that you re-proposing a small decrease in the FY 2015 Budget Request for the CDFI Fund. Although I hope we will get to discuss this in more detail, I am particularly concerned by a separate proposal within this request to eliminate the Bank Enterprise Award Program within the CDFI Fund. I have heard numerous concerns about this idea from various stakeholders and just recently visited a CDFI that has been able to do great work in my district with funding from the BEA. This part of the program is long-standing and I don't know that it makes sense to try and eliminate it at this time.

Secretary Lew, there remain great challenges for your agency in the year ahead with the continued implementation of the tax provisions of the Affordable Care Act, the ongoing stewardship of our economic recovery, and the need for further investment in key areas. We will work with you to ensure that you have the resources to accomplish all of these goals. As you know, you and I have worked together through this Appropriations Committee and other committees many times before. I have great respect for you and for your abilities and we hope that we can continue to have that as we move forward. Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you. I would like to now recognize the Chairman of the Full Appropriations Committee, Mr. Rogers, for any opening statement he might like to make.

Chairman ROGERS. Mr. Chairman, thank you for yielding. Having marked up our first two bills in full committee before we broke, that's the earliest by the way since 1974 the adoption of the present Budget Act. So we are well underway with the fiscal year 2015 process and, Mr. Secretary, we are pleased to have you with us this morning to discuss the President's budget for Treasury. Like the Chairman, I have some very significant concerns about the request. We have worked on this Committee in a very non-partisan way for the most part to construct bills that comply with the Budget Control Act and the Ryan-Murray agreement. The Administration's request for Treasury seemingly cast these statutory budget caps—just cast them aside as merely suggestions. We, obviously, understand that it is more difficult to operate in these constrained budget environments, but these challenging times calls for leadership and tough choices, not a \$480 million gimmick that the Congress has patently and repeatedly refused and rejected on a bipartisan basis. It is sort of like *dăavu* all over again.

In contrast, the fiscal year 2014 Omnibus Package is a prime example of what we can accomplish by working together. Under regular order, this Committee was able to provide every facet to the Federal government with adequate responsible funding while continuing to reduce Federal spending, totaling \$165 billion in cuts since fiscal year 2010. As we have collaborated to reduce spending on the discretionary side of the ledger, I would be absolutely remiss if I did not echo the sentiments of Chairman Crenshaw and others in calling for some leadership from this Administration, and your department specifically, on the problem of mandatory spending that's squeezing aside everything else.

Today, mandatory spending, as you know, accounts for two-thirds of Federal spending. When I came to Congress in 1981, we appropriated two-thirds and mandatory was one-third roughly. Now, it is just the reverse and zooming. We have managed to control discretionary. We have reduced discretionary over these last two or three years, but, in the meantime, the mandates are zooming skyward and crowding out everything that you and we want to do on the discretionary side. And I see no leadership out of the Administration, particularly Treasury, about trying to wrestle the mandatory growth to the ground. Mr. Secretary, unless we do something, it is going to completely eat us alive along with the interest on the debt. From transportation projects, medical research, housing assistance, criminal justice, everything else, including military, are going to be shoved aside.

Second, Mr. Secretary, I have some very strong issues with the posture the Administration has taken towards coal-fired generation in developing countries and I simply cannot support many of the policies emerging from Treasury in that regard. Simply put, these policies are bad for domestic industries in America and they are bad for areas in the developing world in dire need of a reliable, low-cost energy source. To be blunt, the U.S. Environmental Protection Agency has thrown up roadblocks at every turn to diminish our domestic producers' ability to mine coal and burn coal. In my region of southern eastern Kentucky, these regulatory attacks have resulted in some 8,000 miners laid off in just the last several months. Men who were making a very skilled wage, \$80,000 to \$90,000 a year now trying to find a job at McDonald's, unsuccessfully, and trying to support children and families because of the regulatory attacks from this Administration. Like salt on an open wound, Treasury has now sent a clear message that the U.S. should no longer be in the business of exporting coal. Your department issued new rules last year and now the United States will vote against financing any new coal power plant by the World Bank, unless it is in one of the poorest countries or the project uses carbon capture technologies that are not readily available even in the U.S. These policies deny our companies the ability to provide developing countries with more efficient technologies and they encourage these countries to look for financing from investors with lower environmental standards, particularly China.

I would even go far as to say these policies show that this Administration is in denial about the reality of expanding energy access to the poorest nations. For example, I do not understand how the Administration can possibly meet its goal of providing more

power for African countries if coal is left out of the equation. I hope that you could help us understand that.

Finally, in response to Russia's continued threats against Ukraine, we want to hear about the Administration's efforts to support our friends and allies, particularly yesterday's announcement of additional sanctions. Unquestionably, the U.S. must send a strong signal and demonstrate leadership in the international community that such acts of aggression in violation of Ukraine's territorial sovereignty are unacceptable and should not be allowed to continue with impunity. Mr. Secretary, we look forward to hearing your testimony. Welcome to the Committee.

Mr. CRENSHAW. Thank you. I would like now to recognize Mrs. Lowey, who's the ranking member of the Full Committee for any opening statements she might have.

Mrs. LOWEY. Thank you Mr. Chairman, and I would like to thank you and Ranking Member Serrano for holding this hearing. And to my friend, Secretary Lew, thank you for joining us today. We are indeed fortunate to have a person with your wisdom and your talent in public service today. We appreciate it.

Mr. Secretary, your fiscal 2015 budget requests \$13.8 billion to support the Department of the Treasury. As you note in your testimony, businesses have added more than 8.9 million jobs over the last 49 months and the economy and housing markets continue to improve, and yet much more must be done to provide access to capital and get people back to work. Taxpayers need clarity in the tax code and responsiveness from the IRS. The budget would address the funding shortfalls that the IRS, which amazingly have resulted in 39 percent of phone calls going unanswered in FY 2013. This is unacceptable. The American people deserve better. I am pleased that your budget would address this deficiency.

I am also pleased to see that the budget proposes to extend the Terrorism Risk Insurance Program or T-R-I-A, TRIA. This vital program, which is scheduled to expire at the end of this year, provides a federal backstop for insurance claims resulting from acts of terrorism. If TRIA were to expire infrastructure investments and capital projects throughout the country would come to a halt. My friends on the other side of the aisle often say that the government should not be in the business of doing the private sector's job, as there is no affordable and accessible Terrorism Risk Insurance Program in the private sector. TRIA is very much a federal responsibility and TRIA should be reauthorized without delay.

Unfortunately, your hearing before the Subcommittee on State and Foreign Operations could not be rescheduled. I want to take the opportunity now to reiterate my strong support for IMF reforms. The IMF is an excellent tool to help stabilize struggling economies and protect our own financial institutions from getting directly involved in bailouts caused by foreign financial emergencies. We need to maintain our leadership within the IMF, expand its lending capacity, and support the quota reforms in order to protect our own economic and security interest.

I also want to commend your department's work, specifically Under Secretary Cohen's office in disrupting terrorist financing networks and enforcement of sanctions against countries such as Iran and North Korea. In particular, sustained implementation of

these efforts must remain the backbone of our Iran policy especially while nuclear negotiations continue. I hope to hear what additional economic actions and sanctions the Administration will seek if negotiations with Iran fail to yield an agreement permanently denying Iran nuclear weapons capability.

And before I close, I want to apologize not because of lack of interest, but I have another hearing directly across the hall. So thank you again for appearing before us.

Mr. CRENSHAW. Thank you. And now I would like to recognize the Secretary for his opening statement. Your written statement will be made part of the record and if you could limit your oral testimony to about five minutes it will give us more time for questions. So the floor is yours.

Secretary LEW. Well thank you Mr. Chairman, Ranking Member Serrano, members of the Subcommittee and thank you for the opportunity to speak about the Treasury budget. I appreciate your cooperation on rescheduling the hearing and I will keep my opening remarks brief.

Let me start by saying what an honor it is to work with the dedicated men and women at the Treasury Department. They are talented public servants who are focused on strengthening our country and they have performed with excellence under quite difficult conditions over recent years and I want to thank them for their service and commitment.

The president's budget addresses the fundamental challenges our nation faces, and the request for Treasury is part of that comprehensive strategy. This request will allow the Department to help maintain a strong economy, sensibly manage the government's finances, foster a greater investment in American communities and small businesses, protect our national security, monitor risks to the financial system, and promote conditions that support economic growth and stability at home and abroad. Over the past five years Treasury has met its responsibilities efficiently and at lower cost. Today's Budget Request builds on that progress. It includes even more ways to cut costs and achieve savings while offering carefully designed proposals to increase the Department's effectiveness.

For instance, we are seeking a second round of funding for the State small business credit initiative which has been enormously successful in strengthening small businesses across the country. We are working to reduce the risks from cyber security attacks by helping to improve the financial sector's resilience to such attacks and investing in Treasury's own defenses and infrastructure. And we are requesting sufficient funding for the Internal Revenue Service so it can provide the kind of quality service that American taxpayers deserve.

As we consider what's in the best interest of taxpayers it is important to note that it is been five and a half years since Fannie Mae and Freddie Mac went into conservatorship. Now is the time to reform our housing system, and I am encouraged that the Senate Banking Committee is making bipartisan progress on this very complex issue. Since the financial crisis, Treasury has played a central role in designing and implementing the most comprehensive reforms to the financial system since the Great Depression. One major piece of unfinished business is housing finance reform,

and we need legislation that protects taxpayers, ensures continued widespread availability of consumer friendly mortgage products like the 30-year fixed rate loan, it provides liquidity during times of economic stress and facilitates the availability of affordable housing in an explicit and transparent manner.

Before I take questions, I would like to talk briefly about Ukraine. The United States and the international community have made it clear that we will continue to stand with the Ukrainian people during this critical time. That's why we are united in our effort to impose costs on Russia for its unlawful and provocative acts. On Monday, the United States responded to Russia's latest actions with additional sanctions which will increase the impact we have already begun to see on Russia's economy from U.S. and international sanctions. We urge Russia to pursue a diplomatic solution to the situation especially as Ukraine moves forward with presidential elections next month.

Finally, we continue to vigorously enforce our highly effective Iran sanctions regime. As a result, earlier today we sanctioned individuals and entities for providing support to the government of Iran and evading oil sanctions and facilitating Iran's ballistic missile procurement.

With that, let me thank you for the opportunity to appear before you today, and I look forward to answering your questions.

[The information follows:]

**House Appropriations Subcommittee on Financial Services and General Government**  
**FY 2015 Treasury Budget Testimony**  
April 29, 2014

Chairman Crenshaw, Ranking Member Serrano, members of the Subcommittee, thank you for giving me the opportunity to speak about the Treasury Budget. The President's FY 2015 Budget requests \$13.8 billion to fund the Department's operating bureaus. This includes an important increase for the Internal Revenue Service and a decrease for the rest of the Department, which I will cover in more detail below.

Let me start by saying what an honor it is to work with the dedicated men and women at the Department of Treasury. They are talented public servants who are focused on strengthening our country. They have endured much over recent years including a federal pay freeze, sequestration, and the government shutdown, and I want to thank them for their service and commitment.

I would now like to turn to an overview of the economy and the substantial progress we have made toward recovering from the worst recession since the Great Depression. We have now experienced nearly five years of growth. A stronger private sector is helping grow the economy and drive deficits lower. Our businesses have added 8.9 million jobs over the last 49 months. The housing market has improved. Home prices are rising, and millions of homeowners are no longer under water on their mortgages. Household balance sheets continue to heal, exports are growing, and manufacturing is making solid gains. And health care costs are growing at the slowest rate in 50 years.

I want to take a moment and quickly applaud the Senate Banking Committee for beginning their markup of important legislation to reform our housing finance system this morning. Now is the time to reform our housing finance sector. Housing starts, new home sales, and existing home sales all reached multi-year highs last year, rates of mortgage delinquency and foreclosure have declined to near pre-recession levels, and the appreciation we have seen in home prices has substantially reduced the share of mortgages that are underwater. But we need to build on that progress, and the pent up demand from years of low household formation combined with generally housing affordability can spur a step up in new construction to reverse the downward trend we have seen in home sales since mid-2013. A resurgent housing sector would boost the economy and generate new jobs, and a successful reform to housing finance would reinforce that cycle.

Five and a half years after the GSEs were put in conservatorship, we still face a housing finance system does not adequately meet the needs of the American people. Far too many potential homeowners do not have access to credit, and will not until there is a clear path to a new system that provides certainty to all participants. The system today continues a flawed dynamic where taxpayers must support future losses at Fannie Mae and Freddie Mac should there be another downturn in home prices. We need to start reform now – and we need legislation to achieve the fundamental reforms that protect both consumers and taxpayers. The longer we put it off, the easier it is to forget the damage to the economy, loss of housing wealth, and instability a system with misaligned incentives and inadequate taxpayer and consumer protections



As the President said in his State of the Union address, we are now better positioned to meet the demands of the 21st century than any other nation.

There is considerably more that needs to be done. While corporate profits have been hitting all-time highs and the stock market has been vibrant, too many in the middle class and those striving to get into the middle class, are struggling to make ends meet.

The President's Budget addresses these challenges. It puts forward proven, pro-growth initiatives to expand opportunity for all Americans. And it fulfills the President's pledge to make this a year of action, while offering a framework for long-term prosperity and competitiveness.

As part of this proposal, the President's request for the Treasury will allow the department to carry out its mission to maintain a strong economy and responsibly manage the government's finances. It will also allow Treasury to foster greater investment in American communities and small businesses, protect our national security, monitor risks to the financial system, and promote conditions that support economic growth and stability at home and abroad.

***Strengthening the economy and job creation, protecting the financial system***

For nearly 20 years, Treasury's Community Development Financial Institutions (CDFI) Fund has been attracting economic development and job creation to America's underserved communities. This year's request includes \$225 million for the CDFI Fund, just over \$1 million below last year's request, including a proposed one-year extension of the CDFI Bond Guarantee program, which provides a source of long-term capital to financial institutions that support lending in underserved communities. Of the total request, \$35 million for the Healthy Food Financing Initiative will support the growth of businesses that improve the availability of affordable, healthy food options in low-income communities.

We are also supporting small business growth by requesting a second round of funding for the State Small Business Credit Initiative (SSBCI), which was enacted in 2010 to empower states to help small companies grow. Just last week, I saw the positive difference SSBCI can make in our communities when I visited New Center Stamping in Detroit. New Center Stamping utilized SSBCI funding to grow and hire new employees, and demonstrates how targeted policies and programs can drive growth, strengthen the middle class, and bolster local economies.

The program's original funding of \$1.5 billion is expected to result in up to \$15 billion in new investments in small businesses by leveraging \$10 in private capital for every \$1 of federal support, and during 2013 states more than doubled their use of these funds. To continue our support for state economic development agencies' work with small businesses, the Budget proposes a new investment of \$1.5 billion for the SSBCI. This additional funding would be awarded in two allocations: \$1 billion awarded on a competitive basis to states best able to target underserved groups, leverage federal funding, and evaluate results; and \$500 million awarded according to a need-based formula based on economic factors such as job losses and the pace of economic recovery.

In the coming year, Treasury will continue to rebuild and reform our financial system. Reforms like the Volcker Rule are transforming the way Wall Street operates, while strengthening our financial system and making our economy an engine of economic growth once again. Going forward, we must remain vigilant to potential new threats to the stability of the financial system, constantly monitoring how risks change and evolve. Treasury will continue to wind down the remaining investments in the Troubled Asset Relief Program (TARP), often recovering more than the original support extended, and continue the operation of TARP's housing programs to help struggling homeowners avoid foreclosure.

The Budget also proposes to extend the Terrorism Risk Insurance Program and to implement programmatic reforms to limit taxpayer exposure and achieve cost neutrality. The extension will preserve the long-term availability and affordability of property and casualty insurance for terrorism risk.

Finally, we seek to improve the protection and resilience of the critical infrastructure in the financial sectors with a special focus on reducing the risks associated with cybersecurity incidents. Working with industry and government partners, we promote best practices, develop incident management plans, and identify, analyze, and share timely and actionable information. Further, this budget includes \$11 million for investments in enhancing Treasury's own cyber-preparedness and the security of Treasury's vast array of unclassified sensitive, classified, and very sensitive intelligence information. We must also ensure that our vital systems and services remain operational even under severe circumstances. As stewards of this information and IT services, it is our responsibility to ensure it is properly secure both from continuously evolving external and insider threats. These improvements to our own systems, and Treasury's continued work with our private sector partners to advance cybersecurity in the financial industry are vital to ensuring continued economic growth.

***Boosting resources for taxpayer services and enforcement measures, finding new efficiencies across Treasury programs***

The President's Budget makes substantial investments in improved taxpayer service and enforcement at the Internal Revenue Service (IRS), as well as in technology that will drive IRS efficiencies in the future. The Budget also builds on Treasury's ongoing efforts to improve efficiency, reduce costs, and streamline operations. The IRS continues its commitment to carrying out its responsibilities, providing quality service to taxpayers and preserving the public's faith in our tax system, but the lack of sufficient funding in recent years has made it difficult to provide the kind of services American taxpayers deserve. While the IRS is working hard to provide the highest possible level of taxpayer service within its limited resources, its funding situation is causing taxpayers to face longer wait times on the phone, and it is taking longer to respond to taxpayer correspondence. A sustained deterioration in taxpayer service combined with reduced enforcement activity could create serious long-term risk for the U.S. tax system, which is based on voluntary compliance.

To counter these effects, Treasury's Budget request includes substantial investments to help strengthen taxpayer service, enforcement, and technology at the IRS. The FY 2015 Treasury Budget includes \$2.3 billion for taxpayer service, supporting initiatives designed to improve the

IRS' ability to provide timely and accurate responses to taxpayer inquiries, as well as make more information accessible in a secure digital environment.

The request for the IRS includes a \$1.2 billion increase, of which \$480 million is financed by a proposed program integrity cap adjustment for enforcement initiatives that provide a high return on investment. This proposed cap adjustment funds strategic investments that will help close the tax gap and will return six dollars for every dollar invested, once fully implemented. The proposed cap adjustment will yield \$2.1 billion in additional enforcement revenue in 2017 and is projected to reduce the deficit by \$35 billion over the next 10 years.

Treasury's request also includes \$452 million for initiatives that are critical to full and effective IRS implementation of the Affordable Care Act, which the Congressional Budget Office has projected will lower the deficit substantially over the next two decades. Thanks to the ACA, 8 million people have signed up for private insurance through the Health Insurance Marketplace, 3 million young adults have gained coverage by being able to stay on their parents' plan, and millions more have secured coverage through Medicaid and the Children's Health Insurance Program. The law is also providing greater security to Americans who already have coverage, making discrimination based on pre-existing conditions and lifetime limits on coverage a thing of the past.

The FY 2015 Treasury Budget builds on our commitment over the past five years to deliver core services more efficiently and at a lower cost to the taxpayer. In fact, the department has been able to propose more than \$1.1 billion in savings in its budget submissions over the past four years. Excluding the IRS, the FY 2015 Treasury Budget reflects a decrease of 1.7 percent below the FY 2014 enacted level and identifies \$154.2 million in efficiency savings and program reductions.

One area where we have made progress has been our multi-pronged effort to expand the use of electronic transactions in conducting the business of government, including electronic payroll savings bonds, electronic benefit payments, and electronic tax collection. These efforts have reduced costs, improved customer service, and decreased susceptibility to fraud. The "Paperless Treasury" initiative has saved the government hundreds of millions of dollars through electronic payment of benefits and increases in the electronic filing rate for tax returns.

It is important to note that the President's Budget also includes a separate Opportunity, Growth, and Security Initiative. This Initiative includes pro-growth investments that are fully paid for by cutting spending and closing tax loopholes. Treasury investments under the Initiative will support progress in the areas of taxpayer service, fiscal transparency, and global food security. This includes \$165 million to support additional IRS customer service improvements, including increasing annual toll-free telephone service levels to over 80 percent, driving responsiveness to taxpayers through correspondence inventory reduction, and bolstering resources to help tackle more highly burdensome identity theft and refund fraud cases.

***Protecting national security interests and preventing illicit use of the financial system***

I want to end by highlighting the Treasury Budget's proposals to protect our national security interests and continue the department's financial intelligence and enforcement activities.

The Treasury Budget proposes \$105.9 million for the Office of Terrorism and Financial Intelligence (TFI), within the Departmental Offices, to oversee and marshal Treasury's intelligence, enforcement, and economic sanctions functions in support of U.S. national security policies and interests. Our funding request reflects Treasury's continued efforts to safeguard financial systems against illicit use and combat rogue nations, terrorist facilitators, money laundering, and other threats to our national security.

In particular, TFI conducted a sustained sanctions campaign against Iran, its agents, and its front companies in response to Iran's continued defiance of United Nations Security Council resolutions related to its nuclear program. As a result, banks around the world have continued cutting off Iran from the international financial sector; this isolation has played an essential role in bringing Iran to the negotiating table.

Last year, we completed more than 500 actions under our sanctions authorities in an effort to disrupt and dismantle the financial networks that support terrorists, narcotics traffickers, transnational organized crime, and the proliferators of weapons of mass destruction. Our sanctions programs are effective because they stand on a foundation of reliable intelligence analysis, strong systemic safeguards in the financial sector, and robust engagement with our financial sector, foreign governments, and foreign financial institutions.

The Ukrainian people have demonstrated tremendous courage as they have charted an independent course for their country and demanded a government that reflects the will of the people. The United States has been at the forefront of building international support for Ukraine, and of holding Russia accountable for its attempts to destabilize Ukraine. And Treasury has played a key role in these efforts, not just through our carefully designed sanctions program but also in monitoring the impacts to U.S. economic interests, pushing forward the U.S. loan guarantee for Ukraine, offering technical assistance to the government of Ukraine, and encouraging support from partners and international institutions such as the International Monetary Fund.

The United States very much wants to see Ukraine prosper. It is in our economic interest and it is in our strategic interests to stand with the people of Ukraine in their time of need.

### ***Conclusion***

The FY 2015 Treasury Budget reflects a careful balance of savings proposals and targeted investments in key priorities.

The proposed savings will be achieved through a combination of efficiency improvements and increased streamlining of operational processes, making Treasury even leaner and more effective as it continues to deliver essential services to the American people.

The Treasury Budget is balanced, responsible and carefully-designed. It adheres to the President's strategy to make our economy stronger while keeping our fiscal house in order. And I am eager to work with you to put it into action.

Thank you and I look forward to answering your questions.

## Secretary of the Treasury



Jack Lew was confirmed by the United States Senate on February 27, 2013, to serve as the 76th Secretary of the Treasury. Secretary Lew previously served as White House Chief of Staff. Prior to that role, Lew was the Director of the Office of Management and Budget (OMB), a position he also held in President Clinton's Cabinet from 1998 to 2001. Before returning to OMB in 2010, Lew first joined the Obama Administration as Deputy Secretary of State for Management and Resources.

Before joining the State Department, Lew served as managing director and chief operating officer for two different Citigroup business units. Prior to that, he was executive vice president and chief operating officer of New York University, where he was responsible for budget, finance, and operations, and served as a professor of public administration. From 2004 through 2008, Lew served on the Board of Directors of the Corporation for National and Community Service and chaired its Management, Administration, and Governance Committee.

As OMB Director from 1998 to 2001, Lew led the Administration budget team and served as a member of the National Security Council. During his tenure at OMB, the U.S. budget operated at a surplus for three consecutive years. Earlier, Lew served as OMB's Deputy Director and was a member of the negotiating team that reached a bipartisan agreement to balance the budget. As Special Assistant to President Clinton from 1993 to 1994, Mr. Lew helped design AmeriCorps, the national service program.

Lew began his career in Washington in 1973 as a legislative aide. From 1979 to 1987, he was a principal domestic policy advisor to House Speaker Thomas P. O'Neill, Jr, when he served the House Democratic Steering and Policy Committee as Assistant Director and then Executive Director. He was the Speaker's liaison to the Greenspan Commission, which negotiated a bipartisan solution to extend the solvency of Social Security in 1983, and he was responsible for domestic and economic issues, including Medicare, budget, tax, trade, appropriations, and energy issues.

Before joining the Obama Administration, Lew co-chaired the Advisory Board for City Year New York and was on the boards of the Kaiser Family Foundation, the Center on Budget and Policy Priorities, the Brookings Institution Hamilton Project, and the Tobin Project. He is a member of the Council on Foreign Relations, the National Academy of Social Insurance, and of the bar in Massachusetts and the District of Columbia.

## PROPOSED 501(C)(4) REGULATION

Mr. CRENSHAW. Thank you very much. And Members, we are going to try to conclude our hearing in an hour and a half so we'll observe the five-minute rule and we'll have as many questions as we can possibly have. Let me start, Mr. Secretary, just a follow up question when Commissioner Koskinen was here with the IRS, we asked a lot of questions about this proposed 501(c)(4) regulation and he told the Subcommittee that he didn't think that the draft would be finalized before November and, I wonder, is that your view as well?

Secretary LEW. Mr. Chairman, I have said on a number of occasions that there are many steps from where we are now to a final rule. There have been extensive comments as you know, roughly 150,000 comments. There is a process for reviewing those, and there is going to be a need for the administrative process to go step-by-step as revisions are reviewed. So I think, yes, his estimate of the timeframe is consistent with our expectation. You know the challenge is to have a conversation about what to do to limit the discretion in this area so that we don't ever see the kind of problems that were reported last year.

Mr. CRENSHAW. I know that you mention 150,000 comments and that's fairly a large number, maybe historic, do you know yet will there be any further hearings when you have that kind of comment?

Secretary LEW. Well I expect that there will be further opportunities for public comment both on the written material that's issued subsequently and potentially with hearings.

Mr. CRENSHAW. So it is hard for you to say when you think it might be finalized?

Secretary LEW. Yes, I think it is going to take a while. You know I have been very clear about that. The goal here is to get this done right. This is a very controversial and complicated area. The proposed rule made clear that there was an active request for comment. So we were not surprised by the comment. The rule is not even complete in every regards because it says there are some areas that without comment it was very difficult to pave a path forward. So it was meant to open a process. I would just point out that last year when this whole issue came to light through the IG report there were a number of recommendations in the report one of which was to clarify this rule and the proposed rule was a first step in that process.

## FATCA

Mr. CRENSHAW. I appreciate that. Let me ask you—I mention in my opening statement about the Foreign Account Tax Compliance Act, that's going after tax evasion, and it is an extensive regulation. It is going to have a profound and far reaching impact on our economy, but sometimes I think when those kind of rules are proposed they have unintended consequences. For instance, you don't want people hiding cash off shore, but if you have a non-cash value insurance, in other words like property and casualty insurance, that's basically a promise by the insurer to provide payment to cover a specific event. Now, in Florida, we have hurricanes and we

have catastrophic events, so people buy insurance, non-cash value insurance, property casual insurance, and re-insurance.

And so it seems like they cannot be used for the purposes of tax evasion and, you know, I don't know that the IRS can see any additional money there. And so the question becomes how did they happen to include premiums that have no cash value in this regulation? Do you know that? And for instance, I am told that these companies are going to have to spend an awful lot of money to demonstrate that there is no cash there and I wonder if somebody did an economic analysis of the proposed rule before.

Secretary LEW. I am happy to go back and look at this specific issue about insurance. The general goal [unintelligible] is one that I know we all support which is to make sure taxpayers cannot evade U.S. taxes or taxes anywhere by hiding their income in overseas accounts. It is a complicated area. One of the reasons that we extended the period was to make sure that we had time to enter into agreements with other countries. There was a great deal of interest in having bilateral agreements. I think it actually has been a tremendous success.

As I go to international meetings, I don't like to use acronyms at meetings, so I would not use an acronym like FATCA but in various accents I heard people saying we need FATCA for all. You know we need it to become a global standard. And so we will work on getting the details right, I am not familiar with the specific issue on insurance premiums but I am happy to look at and get back to you.

[CLERK'S NOTE.—The Department of the Treasury was either incapable or unwilling to answer this inquiry prior to the publication of this hearing volume.]

Mr. CRENSHAW. I appreciate that because I do think we all think that it is a great concept that we want to stop the tax evasion. But if you think about it, if somebody's buying re-insurance or property insurance, there is no way, as I understand it, they can hide any cash in there. It would probably be appropriate just to revisit that and do some sort of economic analysis and if it is not something then they could not be part of that. But certainly it is a great concept overall.

Secretary LEW. I am happy to look at it and get back to you.

Mr. CRENSHAW. Thank you. Now let's turn to Mr. Serrano.

#### BANK ENTERPRISE AWARD PROGRAM

Mr. SERRANO. Thank you, Mr. Chairman. I am going to try to get in at least two questions because I know we have a short time and, Mr. Secretary, you draw a big crowd, as you can see. Great attendance. Your request eliminates the Bank Enterprise Award Program, something I am very concerned about. I have heard very good reports about the impact program is having in my district and elsewhere. In FY 2014, we provided \$18 million for it. Why are you proposing to zero it out this year? And I must tell you that it is been a while since I have gotten so many comments from constituents on an issue as I am getting on this one.

Secretary LEW. Congressman, we had to make a lot of tough choices in this budget as you have to make in the appropriations process. And based on the current fiscal environment we thought



that concentrating the CDFI funds in other areas was the right trade off. You know the appropriated funding level for the BEA Program has decreased over time and it really was a question of concentrating our effort in other very important areas, but we understand that there are some concerns because of this decision.

Mr. SERRANO. Well the big issue here is that you've got programs up and running. You have situations, for instance, in my district, an area that for years the biggest complaint was that there were no banks around and through this kind of funding that this Committee put forth you know local banks were able to spring up and that's a bad pun because one of them is called Spring. But anyway so now they run the risk of falling apart and I don't know what process you have going forward. We certainly have our role to play but I must tell you that this is one that has support in the community and support on this Committee. And so you should keep that in mind as we move forward.

Secretary LEW. I appreciate that Congressman and I know there is support for the other activities that CDFI funds as well.

Mr. SERRANO. Right.

Secretary LEW. So it is a question of competing goods and obviously with unlimited resources we might make other decisions but we did try in this budget in a number of areas to concentrate our effort in a world of very tight budget resources. And this was a trade off that we made but I would be happy to follow up and discuss the matter with you.

#### OFFICE OF FOREIGN ASSET CONTROL

Mr. SERRANO. Thank you. My next question is one that Mrs. Lowey wanted to ask you at her hearing—at this hearing and I wanted to ask you so that merits being asked. The FY 2014 Omnibus required Treasury to submit recommendations for reducing the response time for applications to the Office of Foreign Assets Control, for a general license for humanitarian, non-governmental organizations seeking to provide aide to famine victims in South Central Somalia. While we appreciate the response you've given us it doesn't really respond to the report language. We like to see a more thorough response delivered to the committee. What timeframe do you think you can have to get that to us?

Secretary LEW. Congressman, I would have to go back and check exactly what the timeframe is. I do know that the issuance of licenses in Somalia has been a very challenging undertaking. I have had the responsibility to work on it from multiple different perspectives when I was at the State Department and now obviously at Treasury. And the challenge is to make sure that humanitarian goods are going where they need to go and should go but that we are not seeing support for organizations that are listed terrorist organizations. We have tried very hard to work, to strike that balance to make sure humanitarian supplies can continue to go forward. I am not sure of the exact schedule. I would be happy to get back to you.

Mr. SERRANO. Right, are you at liberty in terms of security issues to tell us what the challenges have been?

Secretary LEW. Well the whole process is one that is some things are public, some are not. Rather than cross the line perhaps we

should have the conversation separately but over time there have been concerns about payments that were used to support organizations essentially charging tolls on the roads to raise funds for terrorist organizations. So there are real concerns on both sides. Obviously our goal in the humanitarian programs is to get the money in, to get it in safely, and to get it in without having there be the kinds of collateral support for people who are not intended to get benefit from these programs. And I am happy to follow up on the timing; obviously humanitarian licenses are very important.

Mr. SERRANO. I realize I have put on your plate two questions that some people would see them as being that far apart because one is very local, one is part of our foreign policy but both speak about growth and support for people so we'll be talking in the future. Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you. Mr. Rogers.

#### MARIJUANA

Chairman ROGERS. Mr. Secretary let me ask you about marijuana. Washington State and Colorado have legalized recreational use of marijuana, but it remains illegal in most States and certainly under Federal law. Nevertheless, the Department of Justice told the governors that it will not challenge their legalization laws and has told Federal prosecutors to de-emphasize marijuana prosecutions.

In addition, and what I want to ask you about, the Treasury Department's Financial Crimes Enforcement Network issued new rules that give banks a green light to do business with marijuana shops, illegal shops. The combination of this guidance should allow both medical and recreational marijuana-related businesses to make full use of banking services and institutions even though they are dealing with an illegal operation. The DEA Administrator recently told a congressional hearing that cash is the driving force for these drug trafficking organizations and the DEA has already seen signs they say that gangs are attempting to exploit the new banking rules.

The issuance for a green light for banking institutions to do business with these illegal marijuana shops and subsequent action by the Treasury Department to in effect rubber stamp that gives me some pause because this is still an illegal product in practically every State. Is it wise to offer regulatory guidance from the Federal government on illegal activity?

Secretary LEW. Congressman, this is a very complicated area. Obviously when two States pass a law making an activity legal in the State there is going to be an increase in activity in that area. Obviously the Justice Department guidance provided guidelines for how prosecution matters would be considered. We believed it was important for there to be clarity in terms of the consistency between the prosecutorial guidelines and the banking guidelines.

The risk of cash transactions is actually something that we were quite concerned about. Without any guidance there would be a proliferation of cash only businesses and that would make it impossible to see when there are actions going on that violate both Federal and State law and would be of real concern. We thought that the clarity, bringing it into daylight was a better solution. Obvi-

ously the real clarity here would require legislation that conformed with a policy. But since we don't have that, it was an attempt to have as much clarity as one can have given the complex situation with the State laws.

Chairman ROGERS. What about cocaine dealers, should not they be given the same break?

Secretary LEW. I am not aware of any State that has legalized activity in that area.

Chairman ROGERS. But are you not aware that practically in every State marijuana still is considered illegal?

Secretary LEW. So the actions we took will really just apply in the States where the state law makes these shops legal. Where the business would be done with cash, if it were not done through banks. And we think that the actions we have taken provide greater transparency and less likelihood of the kinds of behavior that I think we are all most concerned about.

I will note that there have been quite a number of BSA's, the suspicious activity reports filed with us from Washington and Colorado. These reports give us the ability to see where there are transactions in those two states that would violate both their State laws and Federal laws, and I think would indicate the kinds of troublesome behavior and activity that we would all want to be able to see.

Mr. ROGERS. Well, the Department of Justice apparently qualified its approval of legal marijuana only if that State created strong and effective regulatory and enforcement systems. Washington's medical marijuana dispensaries still are not licensed or regulated by the State and yet you waive all of that and allow these regulations and help with banks in doing business with those shops, which are illegal under the State law much less the Federal law.

Secretary LEW. I cannot conclude what is or is not illegal under the State. Obviously the States have to enforce their State law, but they did legalize the opening of these shops and these transactions. The question was whether the transactions would be in cash or through a transparent banking system. And that really is the area where the guidance is meant to provide some clarity.

Mr. ROGERS. But as I saw in Washington State these dispensaries are still not licensed by the State or regulated by the State. If they are not licensed or regulated, from a legal perspective how are they any different from a drug dealer on a street corner?

Secretary LEW. Congressman, I am happy to follow up with you on some of the details of how things are being done in Washington.

Mr. ROGERS. This is not complicated.

Secretary LEW. Most States passed laws that created a space for transactions that under State law are legal. And the guidance we put out was merely meant to facilitate having transparency so that that would not become a kind of cash economy, where there is no way to see when there are transactions that suggest large scale transactions that would actually violate the State law.

Mr. ROGERS. Well, Mr. Chairman, my time is up I am sure. But it is not complicated, Washington State is not regulating those marijuana dealers and yet the U.S. government through your De-

partment are putting a stamp of approval on banks doing business with illegal shops even in the State of Washington.

Secretary LEW. I would just note that when there are suspicious activities that would violate State law, they are being reported, and being followed up on. I think the transparency is something that actually makes enforcement of law more likely to happen in an effective way.

Mr. CRENSHAW. Thank you. Mr. Quigley.

#### IRAN SANCTIONS

Mr. QUIGLEY. Thank you Mr. Chairman, welcome Mr. Secretary. Secretary, before I go on I would like to echo the Ranking Member's concern about the Bank Enterprise Award Program. I understand we all have different priorities, all we are doing today is telling you this is a program that is a high priority for our communities and we understand your response.

In the meantime, half a world away the President said something that he thought the odds of the Iran talks succeeding were about 50/50 and that if they broke that down, additional sanctions could be underway and they could be passed by Congress in a very short period of time. Do you have a sense of what kind of additional sanctions might be in place? What kinds of sanctions seem to be working right now?

Secretary LEW. Well Congressman, I think we have seen that the sanctions that are in place on Iran's oil sector and their financial sector have been very effective. There has been consistent degradation to Iran's economy; you see it in their GDP. You see it in their exchange rate, you see it in their inflation rate, their unemployment rate, you see it in their willingness to come to the table and negotiate.

Now we do not know the outcome of the negotiation. Obviously the President put the assessment out there that made it clear we are going into this with our eyes open. You know sanctions cannot force an outcome, what they can do is create an environment where a leader is feeling the pressure, so that if they want to do what it takes to improve conditions for their people, they have to change their policy.

If, in fact, the negotiations do not succeed, we will look for other means to tighten the pressure. Working with the world community is one of the reasons that the Iran sanctions have been so successful and that we have not been alone. We are working with most of the rest of the world to have it be a sanctions system that has very little leakage. We obviously are hoping and working hard to make those negotiations successful, but we are very much aware of the fact that it could go either way. I am not going to prejudge what steps we would take, but I think the President's determination and mine is that if the negotiations do not go well, we will have a full some set of options to pursue.

#### UKRAINE SANCTIONS

Mr. QUIGLEY. I appreciate that. In a different country, looking at what has worked here the second round of sanctions involving Ukraine, seem to be met with underwhelming response by their stock market. Having just returned from there you get the impres-

sion that the type of sanctions that would work versus Russia might be the same, those dealing with, more specifically, with the energy sector and the banking sector, have those been considered or is this an issue with the European Union?

Secretary LEW. Well Congressman, obviously they have been considered because the President has signed an Executive Order that creates the authority for us to designate sectors should we make the determination that that is the appropriate step.

Mr. QUIGLEY. It just would have been a stronger second step, perhaps.

Secretary LEW. Well I think if you look at the impact on Russia's economy, it is a little misleading to look at what happens day by day, you have to look over the period of time since Russia went into Crimea, since we have imposed sanctions. There has been a quite substantial deterioration in Russia's already weak economy. And we see it in their stock exchange, we see it in their exchange rate, we see it in a number of important economic indicators. They were downgraded to one notch above junk and the rationale in the bond rating was in part, the sanctions being imposed.

I think the question here is how do we proceed in a careful way, step-by-step, building pressure. President Putin has acknowledged that the sanctions are creating pressure on them. Now obviously they did not change their policy. I think that we need to continue to keep our options open. We are prepared to take action and we have made clear we are prepared to take more action if the policy of Russia does not change.

The reality is again working in partnership with our allies is the most effective way to do it. We are seeing movement there; we are seeing even yesterday that the Europeans made additional designations. If you look at the individuals designated in Russia, they are some of the leading business people closest to the government. You know Igor Sechin is the CEO of a huge oil business. You know Sergey Chemezov is the CEO of a big industrial complex that includes arms deals. Gennady Nikolayevich Timchenko is a CEO of Gunvor, which is the biggest energy-trading platform. The Rotenberg are very close personally and are part of the banking system that supports all of the people who are in the inner circle. I think they have gotten the message that we are serious. They have gotten the message that we have more actions that we can and will take. We need to remain determined and push ahead and work with our allies to do it in a way that is an effective way to change the situation on the ground.

Mr. QUIGLEY. We appreciate that and look forward to working with you in the future.

Mr. CRENSHAW. Thank you. Mr. Womack.

#### FATCA

Mr. WOMACK. Thank you Mr. Chairman. And thank you, Secretary, for your testimony here today. I want to go back to FATCA for just a moment and then I have got a couple of other more brief questions. But as has already been mentioned, and I associate my remarks with that of the Chairman and others who have indicated that our collective effort to collect and deter offshore tax evasion is a goal that we all share. I know that some Treasury officials have

insisted that the July 1 FATCA withholding deadline should remain in place, but can you explain for the panel and for our constituents what the risks are to U.S. financial institutions and the U.S. economy if large numbers of banks are required to without the 30 percent tax on routine cross border transactions?

Secretary LEW. The risk of not having the reporting is that transactions go undetected and tax avoidance and evasion goes ahead.

Mr. WOMACK. More to the concept of the regulatory requirements, let's just go in that direction.

Secretary LEW. This is a new regulatory approach. The FATCA law, which was a strong bipartisan law, put in place the authorities that are being implemented. We have been very cognizant of the fact that it is going to require new reporting procedures to be put into place. We are also very cognizant of the fact that it requires cooperation with banks and governments overseas. We extended the deadline in order to facilitate a smooth, effective transition. I think at whatever point it goes into effect, there is going to be a new set of requirements, but I think they are appropriate requirements because if we do not have that reporting, we cannot see where the tax avoidance is taking place. So the bipartisan effort to make sure that we can see what is going on so that we can stop illegal tax avoidance is the purpose of it. You know I wish it could be done without any burden at all; obviously any reporting program creates some extra work. We have tried to keep it simple; we have tried to extend the timeline to do it in a way that makes it as unburdensome as possible to meet the higher goal.

#### DEFICIT

Mr. WOMACK. This year, what will be the estimated budget deficit in this country?

Secretary LEW. I was not looking at budget numbers before I came up here.

Mr. WOMACK. Round numbers.

Secretary LEW. It is around 600.

Mr. WOMACK. 600.

Secretary LEW. It has been coming down. The reason I am hesitating is each time it is estimated we thought it was going to come down 30 or 40; now it is coming down 70. It has been coming down rapidly.

Mr. WOMACK. So \$600 billion, we are going to throw that on top of an already nearly \$17.5 trillion public debt. When I go home, and I have got the debt clock on my website as a lot of my colleagues do, people are concerned about this public debt. When I make my presentations, particularly in large groups, I try to explain to them that as an appropriator, and much to the credit of the people that are on this dias today, and particularly our overall Chairman Mr. Rogers, we have done a very credible job in trimming discretionary spending. But as our overall Chairman said in his remarks, we still have mandatory spending that has not been addressed. Honestly, I am not seeing the leadership there.

I guess my question, Mr. Secretary, is, do you agree that this debt under the interest rate structure that we have today is a

major national concern and that the sands in the hourglass are running on us?

Secretary LEW. Congressman, I have spent much of the last 30 years of working on trying to have a responsible fiscal policy, so I certainly agree that it is a critically important issue. But we have made more progress reducing the deficit at a faster speed than any time since the end of World War II and the demobilization after World War II. We had an enormous coming together of drivers that drove the deficit up, first we have policies that created policy gaps in the early 2000s, then we have the worst recession since the Great Depression. We are not seeing recovery from that. We have seen policy. And I agree that mostly, or very substantially, it has been discretionary spending reduction, there were some tax increases at the beginning of last year.

We have seen entitlement savings, but there are more. We have in our budget proposals for Medicare savings; we look forward to working on a bipartisan basis for many years to reach agreements there. I think that we are on a path where the deficit will be below 3 percent of GDP. We are in a place where we have a little bit of time to deal with it. But I have always believed that you should not wait until your time runs out. So I am not going to say, let's wait 10 years to have the conversation. But we are in a much better place than we were just a few years ago.

Mr. WOMACK. I know my time is up. I yield back.

Mr. CRENSHAW. Thank you. Ms. Kaptur.

Ms. KAPTUR. Thank you. Mr. Chairman, I would like to request at some point, with the Secretary's willingness, a special briefing of our Subcommittee on our sanctions relative to Ukraine and their implications. I do not know if the Chairman would be open to that or not, but I think it is terribly important and I just wanted to make the formal request.

Secretary Lew, thank you so much particularly someone whose career has spanned helping to restore the solvency of Social Security in 1983 all the way up to the balanced budgets of the Clinton Administration, President Obama has put the right American in charge. So we welcome you before our Committee today.

#### HOUSING

I wanted to focus in two areas in this round. First of all in the housing sector where our secondary market is in a bit of a jam at this point, we know that Wall Street's terrible mortgage securitization record created the largest transfer of capital from Main Street to Wall Street in our history. African Americans lost all their accumulated equity since World War II, Hispanic Americans similarly, working class people across this country. I represent communities terribly impacted by the securitization meltdown.

My question is what is Treasury doing, perhaps working with the Justice Department, to recoup some of those assets for these hard-working Americans in communities that have been so devastated? By the way, those banks are doing very well, the major ones that were a part of this. Everybody seems to be fine up there. But have you considered, in addition to recompense from those institutions back to the street, through the people that are at Treasury, had you considered working to develop new mechanisms, such as pilot

efforts with county land banks in places like Cleveland, Lorain, Sandusky, Toledo, to better handle adjustment in the housing sector in these communities? Does Treasury have a mechanism A) to bring the big banks to the table and B) to get more recompense and to initiate working with county organizations, local governments that are trying so hard to prevent further abandonment and adjustment at the local level?

Secretary LEW. Congresswoman, obviously the large dollar settlements are out of the Justice Department's Office of Litigation and we do not directly have a role in that, though there have been some settlements that have put money back into some of the programs, mostly in the Department of Housing and Urban Development. We have a series of programs where we have been actively engaged with local communities and homeowners to help homeowners refinance their mortgages, to help them modify their mortgages.

We have tried to be creative in using programs like the Hardest Hit fund to help the community as well as individual homeowners. I was just in Detroit last week and saw the first demolitions done using Hardest Hit funds because if you have a blighted house on a block that is struggling to stay above water, you need to have the house that is dilapidated and drawing down everyone's values dealt with.

So we are trying in every way we can with homeowner assistance and with community assistance to be engaged in this. We have seen millions of refinancings and modifications. There is obviously a lot more work to do. We have a number of other programs like the SSBCI where we are not dealing with the housing piece of it, but we are dealing with the economic development piece of it to create jobs in those communities. I think we have had great success in that effort.

#### UKRAINE

Ms. KAPTUR. I will have some follow-up for the record. I wanted to shift to Ukraine for a second and just so the Secretary of Treasury knows this, the agricultural sector of Ukraine can pay all the bills as time goes on. I do not find in what we are doing yet as a country we actually are thinking about that power. I can guarantee you, under the corrupt Yanukovich administration, ordinary farmers were being charged 19 percent interest rate, but the friends of the deposed president, Yanukovich were being charged 4 percent. I hope in the financing schemes that the IMF and others are thinking about that the identification of grass roots farmers in that country, not associated with the past regime, that somebody pays attention to those and that competitive interest rates are offered to those farmers because that sector can ultimately pay the bills.

And finally for the record, because you get in meetings that I do not get into, women of that country are feeding that country, in little villages nobody sees them. We need a humanitarian effort in my opinion that brings in good seed, shovels, basic equipment. And I am talking about very humble things like buckets like CARE does around the world, to help these women; 75 percent of the food is raised in those small towns, in those small villages. Nobody sees those women but all you have to do is just look at the satellite over the weekend, you see all the people drive out of Kiev and go out



to these little villages, go get food, and come back into the city because prices have gone up.

So I wanted to put that on the record, because perhaps you can be a voice in the meetings that are occurring to support agriculture among those who really do want reform and help those who are holding that country together at this point as we weather this crisis. So I thank you very much for listening, thank you Mr. Chairman.

Mr. CRENSHAW. Thank you. Mr. Graves.

#### BENEFICIAL OWNERSHIP

Mr. GRAVES. Thank you, Mr. Chairman. Mr. Secretary, good to see you and wish you well on your continued recovery. I wanted to ask your thoughts on a recent proposal that was on the White House blog and I am going to read a little bit about it, but it was authored by Caroline Atkinson, the Deputy National Security Advisor for International Economics. It described in her proposal as requiring that all companies formed in any State to obtain a Federal tax employee identification number in requiring the Internal Revenue Service to collect information on the beneficial owner of any legal entity organized in any state; and for the IRS to allow law enforcement to access this information without following the safeguards in current law that generally require a showing of reasonable cause to believe a criminal act was committed before the IRS shares taxpayer information under Section 6103 of the code.

In light of, and the still unresolved questions and scandals involving the IRS, targeting the opponents of the administration, it concerns justifying the safeguards in Section 6103 are as relevant today as they were right after Watergate when they were implemented. It is incumbent upon Congress to scrutinize the government's use of confidential IRS data about citizens and in protections designed to safeguard even when the administration asserts the national security requires eliminating these safeguards.

I guess knowing that proposal has been issued as part of the President's 2015 budget and it has been described now, just a few weeks ago on the White House blog, would this proposal by the president do away with the requirement that Federal, State, and local agencies establish reasonable cause to believe a crime was committed before sharing confidential taxpayer return information.

Secretary LEW. Congressman, the protections of 6103 are extremely important and we spend a lot of effort to make sure that we honor 6103 in everything that we do. It has to do with the basic trust the American people have in their system, and that is something that is our obligation to maintain.

The issue of beneficial ownership is a very complicated one; it is a complicated one internationally because there is a huge demand internationally to see more transparency into beneficial ownership because it is considered to be one of the things driving base erosion and tax avoidance internationally.

We have taken the view that we have to protect individual information and act in a way that is consistent with the individual protections that are provided at 6103. So I have, on a number of occasions, in international meetings said that we would not make beneficial ownership broadly public but we would only do it through

proper channels, law enforcement agency, and tax enforcement agency to one another. I am happy to look at the blog post and answer any detailed questions that you have about it, but that is our general policy.

Mr. GRAVES. So if 6103 is in place and there is currently a process that requires reasonable cause, I guess my question would be does it improve on protections for U.S. citizens or is it removing protections for U.S. citizens?

Secretary LEW. I am happy to take a look at that blog post and respond in more detail to you.

[CLERK'S NOTE.—The Department of Treasury was either incapable or unwilling to answer this inquiry prior to the publication of this hearing volume.]

Mr. GRAVES. Okay and so I guess just for clarity, do you think it is the Administration's expectation that Congress will curtail the protections in the current law as it relates to 6103 as we look ahead and we are going through the process of some of the other questions dealing with the 501(c)s and such.

Secretary LEW. Well I think that the protection of individual privacy and information and making sure that our system is a fair one and transparent where it should be transparent, but not transparent on personal matters where it should not be is one of our very highest obligations. So I am not aware of any effort for us to change that. As I offered I am happy to look at this particular matter.

Mr. GRAVES. Okay, well, I would hope that the administration would not be proposing any kind of concept that would allow the Internal Revenue Service to serve freely information to other agencies without reasonable cause; and that is what I will be looking forward to your response on.

Mr. CRENSHAW. Thank you. Mr. Diaz-Balart.

#### MARIJUANA

Mr. DIAZ-BALART. Thank you very much Mr. Chairman. Mr. Secretary, good to see you, sir. A few issues, one of them, and I was not going to bring it up except that Chairman Rogers brought it up, it got me thinking obviously. It is your responsibility to enforce Federal law; my understanding is that it has not changed that marijuana is illegal under Federal law. And yet I understand that now your department is doing these guidelines or giving guidance to banks as to how to deal with something that is illegal under Federal law. Are those guidelines going to at least have a very clear statement that marijuana is illegal under Federal law?

Secretary LEW. Our guidelines in no way change Federal law.

Mr. DIAZ-BALART. My question is this, sir, and I apologize, is there in those guidelines, since it is not going to change Federal law, is there a statement stating that this is illegal under Federal law, which the Federal law is correct.

Secretary LEW. We are in no way telling people that things that are illegal under Federal law are legal. The exact language I would have to go back and look.

[CLERK'S NOTE.—The Department of Treasury was either incapable or unwilling to answer this inquiry prior to the publication of this hearing volume.]

Mr. DIAZ-BALART. It would be interesting to note if, in fact, since it is your responsibility is to enforce Federal law and you are giving guidelines on something that is illegal according to Federal law, that at least there should be an indication that it is illegal under Federal law, which is what your obligation is.

Secretary LEW. To be clear, the Department of Justice guidelines make clear their prosecutorial priorities, it does not say that things that are illegal are legal. So I do not think any of the activities confuse the question of Federal and State law. Our concern is that in a very complicated situation where States have made certain activities legal, there will be transactions. Cash transactions, rather than banked transactions, create more risk of illegal behavior. So we tried to put out guidelines so that there would be some clarity for banks to be able to provide some transparency into these transactions.

Mr. DIAZ-BALART. I understand what you said, Mr. Secretary, but I think if a banker receives guidelines on how to deal with certain entities from the Federal government, I think that in itself would make it very unclear whether it is something that is illegal under Federal law. So I just think making that very clear would be something that that would be helpful.

Secretary LEW. I actually think that they very much understand that they are in an area where they are at risk, and they are filing suspicious activity reports and a lot of banks are not taking these accounts. I do not think there is any ambiguity out there in the banking world. They have to walk a very narrow line.

Mr. DIAZ-BALART. Because you do believe that they are at risk if they do so?

Secretary LEW. They are filing suspicious activity reports for behavior that warrants suspicious activity reports.

#### DEBT RESTRUCTURING

Mr. DIAZ-BALART. Secretary, let me bring you to a couple other points that were brought up; one was not brought up, let me start with this one. Last week, Mexico, I heard, was considering filing an amicus brief with the U.S. Supreme Court taking the side of Argentina in a case against U.S. ambassadors. Now we have the Secretary of State and I asked him whether the Department of State would intervene even if asked and he said absolutely not. But now we know by press reports that last July junior officials in your department urged the IMF to file a similar brief before they were overruled, by the way, all credit to senior department officials. The U.S. then obviously withdrew such support. Again, that would have been an unprecedented move by the IMF. Could you tell us with respect to this Mexican brief, has any official in your department encouraged Mexico or expressed approval to Mexico, contacted Mexico at any point in the last year regarding them filing that brief?

Secretary LEW. Well, Congressman, just to be clear we did file in the lower court proceedings, a brief. I am not going to defend Argentina's behavior in any general way but on this narrow issue of law, we do think that the rights of creditors warrants attention and we filed a brief. There is a general policy in the executive

branch to only file amicus briefs at the Supreme Court when invited. So we did not file an amicus brief at the Supreme Court.

Mr. DIAZ-BALART. Right, I am aware of that. My question is have you had contact with Mexico asking them?

Secretary LEW. I have had conversations with my counterparts. I have told them exactly what I have told you, which makes it clear what we think the right legal outcome would be. I think the conversations with the IMF you know, last year kind of reflected them just conforming to the fact that we were not filing a brief, they did not file a brief.

Mr. DIAZ-BALART. But Mr. Secretary, my question is separate. My question is have folks in your department, as far as you know, contacted Mexico, asking or encourage them to do that?

Secretary LEW. I have just said I have had conversations with my counterparts.

Mr. DIAZ-BALART. Counterparts in Mexico?

Secretary LEW. Yes.

Mr. DIAZ-BALART. So you have had those?

Secretary LEW. Yes.

Mr. DIAZ-BALART. You have asked them to?

Secretary LEW. I just told you; they have asked us our views. I have told them what I have told you.

Mr. DIAZ-BALART. I think I am out of time, Mr. Chairman. Thank you, sir.

Mr. CRENSHAW. Thank you. Mr. Yoder.

#### SIFI DESIGNATIONS

Mr. YODER. Thank you Mr. Chairman and Mr. Secretary welcome back to the committee. I have a couple different areas I would like to ask you about this morning. First of all is the SIFI designation that the FSOC is going forward with. And I am concerned that the FSOC is not undertaking a deliberate and thorough process in reviewing the asset management industry for potential SIFI designations. The only public report issued by the OFR on the asset management industry was heavily criticized for failing to demonstrate a complete understanding of the asset management business and the unique characteristics that differentiate it from banks and other financial institutions. The FSOC has not defined what risks it is concerned about with respect to asset managers or confirmed the specific metric and thresholds it is using to evaluate asset managers.

In an apparent effort to deepen its understanding of the industry, the FSOC announced it would hold a round table May 19 so they could hear directly from industry and other stakeholders on this issue, yet last week the Wall Street Journal reported that two asset managers have already been moved to stage two of the SIFI designation process.

Can you please explain why the FSOC is advancing asset managers through the process when it publicly admits it is still gathering information? And what can be done to ensure that proper decisions are made here and that all voices are heard to make sure that we do not make problems worse through improper designations?

Secretary LEW. Congressman, I think that if you look at this issue it is one of many issues that FSOC will be considering. The FSOC was created to look, not in the rear view mirror, but forward at what are the potential risks to financial stability. OFR was asked to do some analysis here, it was not a regulatory action it was a piece of analysis. I will not discuss any specific conversations regarding any entity, I am just speaking to the review of the sector. There is no one on FSOC who knows the outcome of this process because we are still in the fact finding stages. There is going to be a public session, where there would be views presented and some will disagree with the OFR study and I am sure some will support it.

Our challenge is to make sure we ask hard questions and that we are not afraid to ask questions when we do not know whether the answer is yes or no. That is the only way we are going to be able to detect the threats of the future. I think that this is an area where it warrants attention. It is way premature for anyone to be speculating on what the outcome is. I can tell you as the chairman of FSOC, I do not know the outcome, and I should not know the outcome until we are fully informed.

#### DEBT AND DEFICIT

Mr. YODER. I appreciate that. Returning to the national deficit for a minute, my colleague Mr. Womack asked, I think, some very pertinent questions and I wanted to follow up on your responses. I think anyone in Washington that pats themselves on the back for a \$600 billion deficit clearly knows that that is not an achievement that is going to create the fiscal responsibility this country needs to get back to. We now have revenue coming in over our 40-year average, into this government. I believe we have more revenue coming in, dollar-wise than any time in American history. We are running the sixth largest deficit in history only because the last five were the five were larger all within this current Administration. CBO projects another \$6.5 trillion in debt over the next 10 years.

I cannot find anyone in my district, maybe one of my colleagues can find people in their district that want to see us borrow another \$6-7 trillion. We have the President's budget increasing spending beyond that, attempting to increase the deficit to even greater and deficits going up over the rest of the decade, which are attributable to mostly healthcare costs, the Affordable Care Act, Medicare costs, debt, and interest payments. I think many of our colleagues are tired of sending more money to Washington, D.C.; they are tired of the constant request for additional taxes, that Washington cannot live within its means. I think estimates are there \$3 trillion in new taxes coming in over the next 10 years because of tax increases that have occurred in the last couple of years.

I know we talked about the short-term, and congratulations that the Administration feels that \$600 billion is an achievement in a deficit; that is short term. Long term will the Administration get serious about our long-term debt challenges or does it intend to leave this for the next Administration? And if so, what are the specific ideas that the Administration is going to put forward?

Secretary LEW. Congressman, I think that you have to look at where we started and we have made enormous progress. I have not said that I am happy that there is a \$600 billion deficit, but I am happy that we have reduced the deficit and we are on a path towards keeping it coming down so that it will shrink as a percentage of GDP.

I think when you talk about entitlements you have got to be clear, the Affordable Care Act on net is reducing the deficit, not increasing it. The thing that is driving entitlements up is that the baby boom is retiring and people are claiming the Social Security and Medicare that they are entitled to. These are very challenging areas and unless somebody wants to stand up and say they are going to do something other than pay Social Security and Medicare, the solutions are very hard. We have tried over a number of years to work on a bipartisan budget agreement. The President put his every best effort into it; we were not able to get an agreement on a bipartisan basis. Notwithstanding that we have made enormous progress, incrementally doing it on discretionary spending, doing it with the tax bill at the beginning of last year.

I think that right now the most urgent thing facing Americans is what can we do to promote more growth and job creation in this economy. What do we do to get construction and housing moving again? I think we have a little bit of time, I am not saying decades; it is not today's crisis to deal with the deficit. I think today for most middle class families what they want to know is what are we doing to grow the economy. And I think the kinds of things that we have been talking about in terms of helping to make job creation more robust is frankly what we should currently be paying attention to.

Mr. YODER. Thank you, Mr. Secretary. Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you. Ms. Herrera Beutler.

#### DEBT COLLECTION

Ms. HERRERA BEUTLER. Thank you, Mr. Chairman. I have a couple of questions. The first one has to do with debt collection. As you are aware the Washington Post reported on a couple weeks ago, that the government was seizing State and Federal tax refunds. I think they were on their way to about 400,000 Americans who had relatives who owed money to Social Security. And in many cases the people whose refunds were intercepted had never heard of the debts and the debts were as far back as the mid-century. I realize that it was the Farm Bill in 2008 that gave or set up the authority to go back and get back taxes, but I wanted to ask, in my understanding of it, I do not see anywhere where we have given you the authority to offset payments from an individual to pay debts that are not in his or her name, where did you get that authority?

Secretary LEW. Treasury's role is really as an agent of other Federal agencies. The 2008 Farm Bill did create an authority here. The Social Security Administration certified valid claims and Treasury executes on those claims; it does not create them. The Social Security Administration has said they are changing their policy so this is not going to be happening going forward. I think the concerns raised are worthy of further investigation and, frankly, they are a

concern that I share in terms of how some of these notifications issues develop.

Ms. HERRERA BEUTLER. So those folks who had assets seized on behalf of a debt that his or her father had before they even perish when they were a kid, is that money going to be returned then or how are you going to move forward with that?

Secretary LEW. I am not aware of how Social Security is handling retroactively going back. If they are looking at it, I am happy to follow up on that and get back to you.

[The information follows:]

Concerning collecting delinquent debts owed to federal and state agencies through the Treasury Offset Program (TOP), the determination of who is liable to the United States for a debt and the provision of due process are the sole responsibility of the agency to which a debt is owed. Once an agency certifies that a debt is valid, delinquent, and all due process is complete, Treasury must collect that debt. Treasury does not have discretion to decide whether or not to conduct an offset to collect that debt.

Treasury established TOP within the Bureau of the Fiscal Service (Fiscal Service) to implement the Debt Collection Improvement Act of 1996 (DCIA) requirement that Treasury and other agency disbursing officials intercept eligible federal payments to delinquent debtors. TOP compares payee names and taxpayer identification numbers (TINs), as determined and certified by paying agencies, with debtor names and TINs, as determined and certified by creditor agencies. When a payee's name and TIN match a debtor's name and TIN, TOP facilitates the disbursing official's legal obligation to offset the payment and apply the offset funds to the debtor's debt balance. Since its inception, TOP has recovered more than \$69 billion in delinquent debt for federal and state programs, including more than \$32 billion in delinquent child-support obligations.

The DCIA and other applicable laws assign certain responsibilities for federal collection activities to the agencies to which debts are owed, including, as noted above, determining who is liable to the United States for a debt and providing all due process to such debtors. When referring a debt to TOP for collection, agencies must certify to Fiscal Service that the debtor is liable for the debt, that the debt is valid, and legally enforceable in the amount submitted, and that all due process has been completed. Once an agency provides this certification, Fiscal Service does not have the discretionary authority to decide whether to conduct an offset. If, for any reason, a debt is no longer valid and legally enforceable, creditor agencies must take action to remove or otherwise inactivate the debt in TOP.

At minimum, creditor agencies must provide due process before referring debts to TOP, which means they must provide each debtor with written notice of intent to offset at least 60 days before referring the debt to TOP. The notice must explain the debtor's rights and opportunities to dispute the debt, examine and request copies of agency records, request administrative review of the determination of indebtedness, and enter into a compromise or repayment plan acceptable to the agency.

Once an offset occurs, TOP sends a notice to the debtor, which includes the date and amount of the offset, information about the payment that was offset, and the name and contact information for the creditor agency. Debtors may call a Fiscal Service toll-free number 24 hours a day to inquire about their debts that have been referred to TOP. Fiscal Service then refers these inquiries about specific debts and debtors to the appropriate agency. Accordingly, any questions about specific social security debts should be addressed to the Social Security Administration (SSA). We understand that SSA has halted collection of debts over ten years old, pending a full review of its collection practices.

Treasury is committed to collecting monies owed to the federal government consistent with the law.



Ms. HERRERA BEUTLER. I just find it concerning that with your direction or under your permission a federal agency would see it fit to read beyond what is in the law, which says you can go back and appropriately when people owe money, go back and get it, but to then take it a step beyond and say we are going to get it from your kids and your grandkids, without that actually ever having been given permission in the law.

Secretary LEW. Just to be clear, the specific collection item is not something the Treasury exercises judgment over or would exercise judgment over, so I am not the right person to answer some of the questions about how the claim was determined.

Ms. HERRERA BEUTLER. But you do the collection, right?

Secretary LEW. It just triggers a responsibility, yes, but it is not an independent action.

Ms. HERRERA BEUTLER. No, I understand it is not independent, but I guess if you are the one actually taking the money then there is some shared responsibility for ensuring that you are taking it appropriately. No?

Secretary LEW. I think that we all collectively have a responsibility to make sure that we do business in a way that we are comfortable with different direct lines of responsibility and that is why I am not the right person to answer some of these questions.

#### BONUSES

Ms. HERRERA BEUTLER. Okay, switching gears. So let's see, Treasury Inspector General for the Tax Administration recently announced an investigation from October 2010 to December 2012, more than 2,800 employees with recent substantiated conduct issues that resulted in disciplinary action received more than \$2.8 million in bonus awards and more than \$27,000 in time off. Among these more than 1,100 IRS employees with substantiated Federal tax compliance problems received more than \$1 million in cash awards with more than 10,000 hours in time off. Do you believe that that poor performance and especially the failure to pay taxes should be rewarded through bonuses to IRS employees?

Secretary LEW. Congresswoman, our position is that individuals who have been found to have engaged in significant misconduct including nonpayment of taxes should not be eligible for performance awards during the relevant time period. The IRS has already had discussions with the union; this is a collective bargaining agreement, this bonus program, about the eligibility standards for performance awards. I understand that the union has agreed to work with the IRS to address this issue so clearly this has to change.

Ms. HERRERA BEUTLER. So any chance you are going to go back and collect that money that was paid if you believe it should not have been given?

Secretary LEW. Well, let's first make the policy going forward and then we can look at questions as to whether or not there is any retroactivity to it. These bonuses were for several years ago; the question is what happens with future bonuses and this will govern that. We have already changed the policy for things that are discretionary bonuses at executive levels so that this kind of performance and misconduct are taken into consideration. Now it will be taken into consideration for all bonuses.

Ms. HERRERA BEUTLER. Thank you. I yield back.

Mr. CRENSHAW. Thank you. One thought, Mr. Secretary. Someone mentioned the FSOC and I would just leave you with one of the concerns that I hear from time to time that there are complex issues that are dealt with by FSOC that some would argue that other regulators that have the expertise in those areas. So I just want to share that concern that you not reinvent the wheel and duplicate regulatory aspects, just something that we have heard from time to time.

I want to thank you very much for being here today, for working with us to reschedule this hearing and being here under less than ideal circumstances. I want to thank the Members for their interest and their attendance today. And so with that the meeting is adjourned.

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**Questions for the Record Submitted by Chairman Ander Crenshaw**

***International Monetary Fund (IMF)***

**Earlier this year, the Administration stated that Ukraine could not receive more than \$12B from the IMF unless Congress enacted legislation on IMF quotas. This legislation was not enacted, yet on May 1, the IMF announced that Ukraine had agreed to a \$17B stand-by arrangement. Please explain the discrepancy in the information provided.**

**Question 1: Other than the pending quota “reforms”, what real reforms does the Administration support for the International Monetary Fund?**

**Answer:**

Under normal limits, an IMF borrowing member may request cumulative access to IMF resources of up to 600 percent of the member’s IMF quota. Ukraine’s IMF quota is currently equivalent to about \$2 billion. For Ukraine, 600 percent of quota is about \$12 billion. Implementation of the 2010 IMF quota and governance reforms would have resulted in an increase in Ukraine’s IMF quota, and hence, the amount of access to IMF resources that Ukraine could have requested under the assumption of unchanged normal access limits.

In discussions with Congress, the Administration always noted that exceptional access was possible. In the end, the IMF Executive Board determined that Ukraine needed access to more than 600 percent of its quota under the Stand-By Arrangement, and decided to allow exceptional access.

The 2010 quota and governance reforms remain critical to U.S. national security and economic policy interests, and the Administration is seeking congressional passage of the necessary legislation as a top priority. Beyond the 2010 reform package, the United States continues to promote reforms to strengthen IMF surveillance, enhance transparency, and maintain support for low-income countries through the IMF.

Since the global crisis, the United States has encouraged the IMF to strengthen its focus on crisis prevention and multilateral surveillance through increased coverage of financial stability, debt sustainability, and external sector issues, as well as analysis of the spillover effects of country policies. The IMF now produces annual spillover reports and external sector reports, and has enhanced its analysis of financial stability issues in Financial Sector Assessment Program (FSAP) reports. The United States continues to urge the IMF to undertake more rigorous, candid, and evenhanded bilateral surveillance of its members’ policies to reduce vulnerabilities and to promote global growth and stability.

The United States consistently advocates for greater transparency at the IMF, including enhanced disclosure of economic and financial information by IMF member countries. Extensive information about the IMF’s operations and activities is publicly available on the IMF website, and the vast majority of IMF country reports are now published.

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In addition, with strong U.S. support, the IMF has significantly increased its support for low-income countries, including through interest rate relief on its concessional loans and helping protect health and education spending.

**According to the IMF Website, another round of quota increases is expected if and when the pending quota “reform” package is enacted.**

**Question 2: Please explain the range of options being considered for the next quota review?**

**Question 3: Will the Administration consult with Congress, including the appropriate committees and Leadership, prior to making any new commitments?**

Answer to Questions 2 and 3:

There have been no discussions on the next IMF quota review (15th General Review of Quotas). In April 2014, the International Monetary and Financial Committee (IMFC), a ministerial-level advisory committee of the IMF, reaffirmed the importance of implementation of the 2010 quota and governance reforms prior to beginning discussions on the next quota review:  
<http://www.imf.org/external/np/cm/2014/041214.htm>.

I will consult with Congress prior to beginning international negotiations in the context of the next review of IMF quotas.

***Exchange Stabilization Fund***

**Question 4: What was the balance of the Exchange Stabilization Fund at the end of FY13?**

Answer:

The ESF's total assets were \$101,769,147,574.26 at the end of FY 2013. Please note that this information is available to the public at <http://www.treasury.gov/resource-center/international/ESF/Pages/reports.aspx> and <http://www.treasury.gov/resource-center/data-chart-center/IR-Position/Pages/default.aspx>.

**Question 5: Please provide a chart of the ten largest transactions conducted by the Exchange Stabilization Fund in FY13.**

Answer:

There were no transactions conducted during FY 2013. (For reference, the last transaction conducted by the ESF was a Special Drawing Rights purchase in June 2011.)

***Multilateral Development Banks (MDB)***

**Question 6: Please provide a list of each bank and their policy to publish all audits, performance and financial, online.**

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Answer:

World Bank:

The World Bank's annual audited financial statements can be found online, with certification from the Independent Auditor (currently KPMG).

[http://siteresources.worldbank.org/EXTABOUTUS/Resources/29707-1280852909811/IBRD\\_Jun\\_13.pdf](http://siteresources.worldbank.org/EXTABOUTUS/Resources/29707-1280852909811/IBRD_Jun_13.pdf)

In addition, the World Bank Group's financial data, including where the Bank has disbursed, what global funds the Bank manages, and the procurement under project financing, can be found online through the Open Financial Data site: <https://finances.worldbank.org/>

Reviews of the World Bank Group's activities by the Independent Evaluator are also online: <http://ieg.worldbankgroup.org/>

Finally, the ratings agencies all make their ratings reports of the IBRD public as well.

African Development Bank (AfDB):

The AfDB policy on access to information presumes disclosure, except for a short “negative list” – that is, a limited set of documents that are explicitly excluded from disclosure. This policy came into effect in February 2013. In the Information Disclosure Handbook (also launched in February 2013), the AfDB makes specific reference to the disclosure of audited financial statements in the list of items to be posted on the website upon receipt from borrowers.<sup>1</sup> In addition, like its peers, the AfDB, also posts overview assessments of project performance on its web site.

Inter-American Development Bank (IDB):

The IDB approved the Access to Information Policy (AIP) in 2010, significantly strengthening its commitment to transparency and more closely harmonizing its disclosure practices with peer institutions. The AIP presumes public disclosure of information, including the timely availability of all operational, financial, and institutional documents, except for a list of ten narrowly-defined exceptions (e.g., restrictions on disclosure of personal, legal, and investigatory information). One notable exception is that the authorities in a borrowing country can object to the public disclosure of country-specific information in IDB documents. In the event of an objection, the country authorities must provide redacted statements. If the country objects to the entire document being disclosed, the IDB releases a summary of the document and a public notice that the country has requested nondisclosure. The U.S. has consistently pressed for reports on the application of this exception, and IDB Management continues to cooperate by actively discouraging countries from requesting nondisclosure. A Board-approved external review panel has been established to review appeals in which claimants seek to reverse nondisclosure decisions.

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<sup>1</sup> Available at: <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Policy-Documents/DAI%20Staff%20Handbook.pdf>

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The IDB has established an office tasked specifically with implementing the AIP, which includes providing ongoing technical support to different IDB units. The U.S. continues to press for stronger implementation of the AIP at the IDB.

**Asian Development Bank (AsDB)**

The AsDB approved its Public Communications Policy in 2011 following wide consultations with external stakeholders. The AsDB has a presumption in favor of disclosure, except for items contained in a negative list (as is the practice at other MDBs). This disclosure requirement includes information on performance and financial audits. As stated in the 2011 Public Disclosure Policy, the AsDB posts annual audited project accounts for sovereign projects on its website. The procedures for the disclosure of annual audited project accounts are discussed and agreed with each borrower and made part of the loan agreement for each project. In addition, the AsDB's financial statements are published annually and are available on the Bank's website.

As is the case with other MDBs, the AsDB's disclosure policy contains a right to appeal for disclosure in instances where the AsDB retains the right not to disclose. When stakeholders believe the AsDB has denied their request in violation of its policy. This process includes an independent decision making body separate from the AsDB.

**Question 7: Please provide the current level of budget support at each bank for 2012, 2013, and projected for 2014.**

Answer:

<b><u>Policy Based Lending – Billions USD</u></b>			
	<u>FY12</u>	<u>FY13</u>	<u>FY14</u>
World Bank	12.1	9.1	9 to 10
AfDB	1.1	0.8	1.8
AsDB	2.5	2.1	2
IDB	2.3	4	2.7

***World Bank Procurement Review***

The World Bank launched a review of its procurement policies in May 2012 in part to try to find ways to use local systems in emerging market countries.

**Question 8: What steps is the U.S. taking to ensure that the end result of this review will be to elevate World Bank procurement standards and not to weaken them?**

**Question 9: How can you assure the Committee that the World Bank will not reduce oversight as a result of this review?**

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Answers to questions 8 and 9:

The United States is heavily engaged in the ongoing review of the Bank's procurement systems. We are committed to helping ensure that any potential use of country systems does not compromise a level playing field for U.S. firms, and that there is a strong and appropriate oversight mechanism for procurement practices. We are confident that the review is proceeding in a direction that maintains equitable access, enhances flexibility for clients, and favorably impacts high-quality bidders.

Bank management also wants to adopt a new risk-based approach to oversight of procurement contracts, and we agree that the current approach to prior and post-review is inefficient and costly. We want the World Bank to focus its prior and post-review resources on the top dollar contracts, and those sectors and countries that are most prone to corrupt practices. In addition, we are advocating that the new framework include risk-based sampling for prior review to act as a check on this approach.

**The U.S. is the largest World Bank donor and yet U.S. companies are not even on the top 10 list of countries whose companies win bids for World Bank projects.**

**Question 10: Can you explain why?**

**Question 11: What steps will the Administration take to ensure that U.S. companies are treated more fairly in the World Bank procurement process?**

Answers to questions 10 and 11:

We broadly support many of the principles outlined in the new procurement framework, such as greater use of non-price factors (e.g., quality or after sales service) in the awarding of contracts, rather than only the lowest cost options, as a way to level the playing field between American firms and firms from other nations. The World Bank wants to expand its practice of evaluating bids in light of the "whole life cost" of the package proposed by bidders – including acquisition cost, cost of maintenance and running costs, and disposal cost. U.S. firms are very strong competitors once the "whole life cost" is taken into account.

In order to enhance fair treatment for all bidders, we are also pushing the World Bank to adopt a more robust complaint handling mechanism for firms that believe they have lost a bid under unfair circumstances. Reforms in this area include establishing a single point of contact within the Bank to handle complaints, implementation of a tracking system that follows cases through to resolution, a mediation role for the Bank with country procurement authorities, and clauses to provide bidders with the right to independent arbitration in contracts above a specified dollar amount.

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***North American Development Bank (NADBank)***

**Question 12: What is the Administration doing to promote the use of the NADBank and require it to do more to help the people living along the U.S.-Mexico Border?**

Answer:

The NADBank is well respected among states and communities on both sides of the U.S.-Mexico border, where it has had a tangible impact. For example, largely as a result of NADBank's investments, the percentage of people living on the border with access to wastewater treatment has risen from 20 percent in 1995 to 87 percent today, benefiting 12 million residents.

To further build upon its accomplishments, the Administration has placed NADBank in a central role as part of the High Level Economic Dialogue (HLED) between the United States and Mexico. NADB has initiated a study of points-of-entry infrastructure projects along the border. NADB will also continue its work in water and wastewater, energy generation and transmission, and water conservation, among other priorities. Under the HLED, the U.S. and Mexican governments are also undertaking a review of NADBank's capital needs.

**Question 13: What is the annual operating income earned by the NADBank, what are the overhead costs, what is the level of outstanding loans and guarantees, and what is the number of employees for fiscal years 2013 and 2014 (projected)?**

Answer:

Fiscal Year 2013:

NADB annual operating income earned: US\$19,872,454

NADB overhead costs: US\$1,565,900

NADB outstanding loans: US\$1,001,211,596

NADB outstanding guarantees: None

Number of NADB employees for fiscal years 2013 and 2014: 56 and 58, respectively

**Question 14: Please provide a list of all loans and or programs approved and funded in fiscal year 2013.**

Answer:

**Loans Approved in 2013 (US\$)**



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Loan Approvals		Date	US\$
1	IID Community Solar Park in Brawley, CA	Mar-13	19,200,000
2	El Centro Solar Park in El Centro, CA	Apr-13	64,966,894
3	Basic urban infrastructure project in Hermosillo, Sonora	May-13	19,103,090
4	Landfill gas-to-Energy in Saltillo COAH	May-13	3,074,434
5	Ramona Solar Project 1 in Ramona, CA	Sep-13	8,000,000
6	Ramona Solar Project 2 in Ramona, CA	Sep-13	19,900,000
7	Valley Center Solar Project 1 in Valley Center, CA	Sep-13	10,100,000
8	Valley Center Solar Project 2 in Valley Center, CA	Sep-13	20,300,000
9	Paving & roadway improvements in San Luis Rio Colorado, SON	Sep-13	8,597,631
10	Alamo 4 Solar Park in Brackettville, TX	Oct-13	50,000,000
11	ESJ Wind Energy Project in Tecate, BC	Nov-13	50,000,000
			<b>273,242,049</b>

**Loans Funded (Disbursed) in 2013 (US\$)**

Loan Disbursements		US\$
1	Paving project in Mexicali, Baja California	2,040,244
2	Water and wastewater project in Tijuana/Playas de Rosarito, Baja California	1,796,936
3	South-south Wastewater Treatment Plant in Ciudad Juarez, Chihuahua	3,104,525
4	Wastewater Treatment Plant in Hermosillo, Sonora	16,080,789
5	Basic urban infrastructure project in Hermosillo, Sonora	11,079,748
6	Paving & roadway improvements in San Luis Rio Colorado, Sonora	8,597,631
7	Water and wastewater project in Matamoros, Tamaulipas	12,784,961
8	Davis-Monthan AFB Solar Park in Tucson, AZ	24,024,693
9	El Centro Solar Park in El Centro, CA	53,532,377
10	Ocotillo Wind Express Farm in Imperial County, CA	37,410,577
11	Ramona Solar Project 1 in Ramona, CA	5,330,319
12	Ramona Solar Project 2 in Ramona, CA	13,275,703
13	Valley Center Solar Project 1 in Valley Center, CA	6,440,529
14	Valley Center Solar Project 2 in Valley Center, CA	12,836,578
15	Bryan Solar Park in Presidio, TX	6,628,634
		<b>214,964,344</b>

Beyond project certification and financing, the Bank did not begin any new initiatives in 2013. One grant program—the Water Conservation Investment Fund (WCIF)—was discontinued and will be closed out once the last four projects are fully disbursed. Uncommitted WCIF funds totaling US\$1,055,196 were rolled over to the Community Assistance Program (CAP).

**Question 15: What is the balance of the special reserve and what transactions were made from the Special Reserve in 2012 and 2013?**

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**Answer:**

As of December 31, 2013 and 2012, the Special Reserve balance was US\$30,034,667 and \$27,342,816, respectively. During the years ended 2013 and 2012, US\$2,691,851 and \$13,791,081 were transferred from undesignated retained earnings to the Special Reserve. No funding has ever been expended from the Special Reserve.

**Question 16:** What are the unobligated and unexpended balances of the NADBank's Community Adjustment and Investment Program (CAIP)?

**Question 17:** How many employees are currently paid for out of CAIP funding?

**Question 18:** Please provide a detailed list of all CAIP funding projects in FY2013.

**Answers to Questions 16 – 18:**

CAIP has a balance available in cash and cash equivalents of US\$3,794,047 as of December 31, 2013, and a net outstanding loan balance of US\$1,132,380. There is currently one full time employee and one 20 percent time consultant covered with CAIP funds.

The total dollar amount of grants funded since 2009 is US\$6,800,509 in support of projects that are projected to result in the creation of 1,626 private-sector jobs and the preservation of 2,037 private-sector jobs. Of those projects, eight grant projects were in operation in FY 2013 and an additional set of six targeted grants totaling \$1,502,600 were awarded in the first quarter of 2014. It is estimated that 657 private-sector jobs will be created and 966 jobs will be preserved in CAIP-eligible areas as a result of these new targeted grants.

USCAIP Targeted Grant Assistance						
2013						
Awardee	State	Amount of Grant Award	Purpose	Grant Time Period	Anticipated Benefit	GTP End
International Sonoran Desert Alliance	AZ	\$100,000	Commercial real estate renovation for small businesses	2 Years	12 FTE jobs created	4/30/2016
Nogales Community Development Corporation	AZ	\$100,000	Business development and marketing plan	2 Years	30 FTE jobs created, 6 preserved	4/30/2016
California FamLink	CA	\$250,000	Microlending for small agribusinesses	2 Years	175 FTE jobs created, 350 preserved	4/30/2016
Martin County Economic Development Corporation	NC	\$275,600	Shell building revolving fund	2 Years	60 FTE jobs created	4/30/2016
Halifax County Development Authority	VA	\$427,000	Industrial site renovation	2 Years	90 FTE jobs created	4/30/2016
New College Foundation	VA	\$350,000	Manufacturing training facility	2 Years	290 jobs created, 610 created	4/30/2016
		\$1,502,600				

**Foreign Account Tax Compliance Act**

The Administration recently issued final regulations implementing the Foreign Account Tax Compliance Act (FATCA) and will begin to take effect on July 1, 2014. As you know, this is an extensive regulation, and will have profound and far reaching effects on our

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economy. Yet, I believe these regulations are fraught with unintended consequences. Specifically, I am concerned with FATCA regulations as they pertain to premium payments to internationally based insurers to purchase non-cash value insurance. As you know, non-cash value insurance represents pure insurance in that it is a promise by the insurer to provide payment to cover a specific event or series of events. As you can imagine, this is a major issue for the state of Florida when it comes to insuring properties from catastrophic events. Unlike cash insurance, these products provide no financial investment income. As such, Property-Casualty insurance policies simply cannot be used for the purposes of tax evasion and the IRS will not see any additional money by subjecting them to FATCA.

**Question 19: Why did the Administration choose to include insurance premiums that have no cash value in FATCA regulations?**

Answer:

The Treasury Department has had many discussions with stakeholders and with the IRS about the appropriate application of the FATCA rules to non-cash value insurance contracts and companies that issue them. FATCA is a key part of the U.S. government's multi-pronged effort to combat the use of offshore accounts and foreign entities to evade U.S. income tax. When considering how FATCA should apply to non-cash value insurance, it is important to distinguish the risk of tax evasion associated with financial accounts held by U.S. persons at foreign financial institutions from the risk of tax evasion associated with certain privately held non-financial foreign entities that have substantial U.S. owners.

With respect to tax evasion associated with offshore financial accounts, the Treasury Department and the IRS believe that non-cash value insurance contracts present a low risk of being used for tax evasion purposes. Accordingly, the final FATCA regulations issued in 2013 ("final regulations") provide that non-cash value insurance contracts are not treated as financial accounts, with the result that insurance companies are not required to report on the beneficial owners of these contracts. Moreover, a foreign insurance company that only issues non-cash value insurance contracts is not treated as a foreign financial institution under FATCA. If a foreign insurance company is privately held, however, it may be treated as a non-financial foreign entity that is required to provide information about its substantial U.S. owners, if any, to withholding agents in order to avoid FATCA withholding on withholdable payments made to it. While publicly-held foreign insurance companies that issue only non-cash value insurance contracts present a relatively low risk of being used by U.S. investors for tax evasion purposes and thus are not required to provide this information in order to be exempt from FATCA withholding, the final regulations do not exempt privately held insurance companies from this requirement because some closely-held foreign insurance companies that issue only non-cash value insurance contracts may be used by their U.S. owners to invest in foreign assets and avoid reporting to the IRS the income earned on these assets. Information about the substantial U.S. owners of such entities is a key element of U.S. enforcement efforts against these tax avoidance structures. To ensure that this information will be reported to the IRS, the final regulations do

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not exempt U.S. source premiums paid with respect to non-cash value insurance from treatment as a withholdable payment.

**Question 20: Was an economic analysis conducted in respect to subjecting businesses to tens of millions of dollars in compliance costs, when these products are simply unrelated the Act's purpose of addressing tax evasion?**

**Answer:**

Although no economic analysis was conducted regarding costs related to the payment of premiums on non-cash value insurance in particular, the Treasury Department and the IRS always are concerned about reducing potential burdens. To this end, the Treasury Department and the IRS solicited and carefully considered comments from all stakeholders in developing the final FATCA regulations that were issued in 2013 (the "final regulations"). In taking these comments into account, the final regulations reduce potential burdens associated with complying with the FATCA statute for foreign entities and U.S. withholding agents in several important ways. For example, they provide that certain categories of entities are not considered to be foreign financial institutions, and also that certain categories of non-financial foreign entities (including publicly traded foreign entities that issue non-cash value property and casualty insurance or provide related reinsurance) are not required to provide information on their substantial U.S. owners in order to be exempt from FATCA withholding.

The Treasury Department and the IRS will continue to engage with stakeholders to implement FATCA in a manner that appropriately balances the compliance objectives of the statute with the burdens imposed.

***Foreign Account Tax Compliance Act – Transition Period***

**On May 2, 2014, the IRS announced in Notice 2014-33 that calendar years 2014 and 2015 will be regarded as a transition period for purposes of implementing Foreign Account Tax Compliance Act. The purpose of the transition period is to facilitate an orderly transition for compliance.**

**Question 21: What potential financial market risks and disruptions does the Department anticipate avoiding as a result of this newly announced transition period?**

**Answer:**

Notice 2014-33 provided that calendar years 2014 and 2015 will be regarded as a transition period for compliance with FATCA and the modified chapter 3 regulations. In the absence of a transition period for compliance, the potential for over-withholding on U.S. source payments and the potential effects were uncertain. The Notice mitigates the effects of potential over-withholding on entities while at the same time continuing to meet the information reporting objectives of FATCA. The Notice takes into account stakeholder comments with respect to the uncertainty for over-withholding and provides time to transition to using new Forms W-8s to document new entity accounts.

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The Treasury Department and the IRS will continue to engage with stakeholders to implement FATCA in a manner that appropriately balances the compliance objectives of the statute with the burdens imposed.

**Question 22: Did the lack of intergovernmental agreements with some key countries contribute to the Department's decision to introduce a transition period? How many countries is the Department currently negotiating intergovernmental agreements with? How many countries does the Department expect to have intergovernmental agreements with by the end of calendar year 2015?**

Answer:

No, it did not. As of May 21, 2014, the Treasury Department has 66 Intergovernmental Agreements (IGAs) treated as in effect and we continue to remain actively engaged in negotiations with many more jurisdictions. It is uncertain how many IGAs we will have negotiated by the end of calendar year 2015.

**Question 23: How is "good faith effort" determined and measured? What other tax laws require the Internal Revenue Service to make a determination of "good faith effort"?**

Answer:

The good faith standard will be applied by IRS based on facts and circumstances to determine whether withholding agents or FFIs can demonstrate that they have reasonably adapted business practices to apply the withholding, reporting, and due diligence procedures under FATCA as described in Notice 2014-33. The IRS has previously used this approach numerous times, in particular when it introduced or significantly revised due diligence, reporting, and withholding requirements. See, e.g., Notice 2001-4, Notice 99-25, Notice 98-16.

*Financial Stability Oversight Council*

Mr. Secretary, you are the chair of the Financial Stability Oversight Council. I hear concerns from financial institutions in my district and across the country about the activities of the FSOC. These concerns center around the FSOC taking regulatory actions on very complex matters that may be better handled by individual regulators. An example being that the SEC has more expertise in securities than other members of the FSOC, so the FSOC should defer to the SEC on these types of issues, not try to recreate the wheel or regulate on issues outside of its expertise. Another concern is that the FSOC is dominated by officials of the Administration in power, while in many cases a regulatory agency is led by a bipartisan group of Commissioners or Boards. In that case, multiple points of view are debated in the rule making process.

**Question 24: How do you ensure that the FSOC does not intervene or duplicate issues better handled by specific regulator?**

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Answer:

Before the creation of the Council, no agency had responsibility for identifying and responding to potential risks to financial stability. Based on the lessons learned from the 2008 financial crisis, the Council was established by the Dodd-Frank Act with a clear statutory mission to identify risks to the financial stability of the United States, to promote market discipline, and to respond to emerging threats to the stability of the U.S. financial system. When the Council identifies potential risks within the existing jurisdiction of a regulator, the regulator is often best positioned to take action to mitigate those risks, and the Council works closely with all the federal financial regulators. At the same time, the Council has the unique statutory responsibility under the Dodd-Frank Act to look across the financial system and to prevent risks to financial stability from slipping through the cracks.

**Question 25: How do you ensure that the FSOC gets input from all points of view and not just the points of view of the Administration currently in power?**

Answer:

The Council has 15 members with a broad variety of backgrounds, including federal and state regulators. Beyond the banking regulators, three of the 15 Council members are specialists in insurance, and three are securities or commodity market regulators. Additionally, the Council is supported by staff with relevant expertise, most of whom are career government employees.

**Question 26: What are you doing to relieve the concerns and uncertainty in the financial community that the FSOC will impose burdensome and perhaps duplicative regulations or data collection requirements on top of those already in place from individual regulatory agencies?**

Answer:

The Council has not adopted any substantive regulations or data collection requirements, and it does not have plans to issue any additional rules at this time. Its only rulemakings have been to implement procedures for its statutory responsibilities related to the designations of nonbank financial companies and financial market utilities, and to implement the Freedom of Information Act. In order to mitigate the potential for duplication of both current and future data collections, the Office of Financial Research, in conjunction with the Council's Data Committee, has compiled a publicly available inventory of data currently collected by the Council's member agencies.

*President's Working Group on Financial Markets*

**The President's Working Group on Financial Markets is composed of the Treasury Secretary and the Chairs of the Fed, the Securities Exchange Commission (SEC), and the Commodities Future Trading Commission (CFTC). The Financial Stability Oversight Council (FSOC), is composed of a number of members, including the Treasury Secretary and the Chairs of the Fed, the SEC, and the CFTC. Unlike FSOC, however, the**

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**President's Working Group on Financial Markets appears to have never produced minutes of any of its meetings that could be reviewed by Congress or the public.**

**Question 27: Given the overlapping membership and scope of these groups, how does Department justify the continuation of the President's Working Group on Financial Markets?**

Answer:

The President's Working Group on Financial Markets (PWG) was established by President Reagan in 1988 to further goals of enhancing the integrity, efficiency, orderliness, and competitiveness of our Nation's financial markets and maintaining investor confidence. As such, it has served as a forum to discuss and coordinate public policy issues among its four member agencies.

While the role of the PWG as a forum for discussion has largely been supplanted by the Financial Stability Oversight Council, which was established in 2010 by the Dodd-Frank Act, the PWG continues certain work, notably through its Financial and Banking Information Infrastructure Committee.

#### *New Offices*

**In April, the Department advised the Committee that it created a new State and Local Finance office and a new Office of Federal Program Finance to address governmental financing issues at the Federal, State, and Local levels.**

**Question 28: What specific governmental financing issues at the Federal, State, and Local levels has the Department been confronted with that merit two new offices?**

Answer:

The Office of State and Local Finance was created to better coordinate and lead Treasury's efforts to monitor and respond to developments in state and local municipal finance markets. Monitoring developments in the municipal finance markets and their broader economic implications has long been a key component of Treasury's efforts to promote financial stability and economic growth. Similarly, the Office of Federal Program Finance was created to coordinate the Treasury's policies on techniques used by Federal agencies and public sector entities to finance their programs, including their borrowing, lending, and investing activities.

**Question 29: How are these offices not duplicative of activities of the Securities and Exchange Commission?**

Answer:

Neither of these two offices serve a regulatory function, as Treasury is not a regulator. The Office of State and Local Finance was set up to establish a centralized resource to coordinate the

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Treasury's policy responses related to State and Local government issues and to monitor municipal bond markets. Similarly, the Office of Federal Program Finance was set up to monitor the borrowing, lending, and investing activities of Federal agencies and public sector entities.

**Question 30: Please provide an organization chart of the Office of Domestic Finance before and after the creation of these two new offices.**

Answer:

The current organizational chart of the Office of Domestic Finance is available on the Treasury website at <http://www.treasury.gov/about/organizational-structure/offices/Pages/Domestic-Finance.aspx>.

***Bonuses***

**In July 2013, Acting IRS Commissioner Werfel eliminated bonuses for employees, averting the need for additional furlough days. Commissioner Koskinen reversed that decision in February 2014 while also complaining about inadequate funding for customer service.**

**Question 31: How many more phone calls could the IRS answer with \$64 million?**

Answer:

Performance-based awards are an important part of managing and incentivizing excellent customer service. Additionally, performance-based awards for bargaining unit employees are required by a January 2014 settlement agreement between the IRS and the National Treasury Employees Union (NTEU). Provisions requiring awards for high performing bargaining unit employees have been included in IRS contracts with NTEU for many years.

The exact number of calls that can be answered by the IRS depends on various factors, but we estimate that the \$137 million requested in the FY 2015 President's Budget to increase telephone responsiveness will increase the Customer Service Representative level of service (LOS) from the actual FY 2013 level of 60.5 percent to 71 percent.

**Last week, the Treasury Inspector General released a report that documented IRS' practice of providing bonuses to employees with substantiated conduct issues, including nonpayment of Federal taxes.**

**Question 32: Does Treasury provide bonuses to employees with conduct and tax compliance issues?**

Answer:

Our position is that individuals who are found to have engaged in significant misconduct should not be eligible for performance awards during the relevant period. In some instances, collective bargaining agreements may have provisions relating to the payment of awards. For example, the



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IRS is discussing the eligibility standards for performance awards with the National Treasury Employees Union.

***Earned Income Tax Credit (Tax Policy)***

**The President's budget proposes to increase both eligibility and payments for the Earned Income Tax Credit (EITC). If enacted, the proposals would result in a revenue loss of \$81 billion and increased payments of \$64 billion over 10 years. This refundable tax credit can be a powerful reward to join or remain in the workforce.**

**Question 33: But why did the Administration propose to expand a program with a 25 percent improper payment rate and a 20 percent underutilization rate without also making the credit calculation simpler to understand and to enforce?**

Answer:

Compliance by taxpayers claiming all tax benefits, including the EITC, should be improved. To that end, IRS is working on new initiatives to improve EITC compliance, and our Budget includes several provisions to improve overall tax compliance that are particularly applicable to the EITC.

The EITC compliance problems that are most difficult to address are related to complicated family circumstances and to eligibility criteria related to qualifying children that IRS cannot readily observe and for which there is no third party reporting. To a large extent, these issues do not apply to the EITC for workers without children, which the Administration proposes to expand in the FY 2015 Budget.

Under the Administration's proposal, the expanded EITC would provide support to 13.5 million low-income workers struggling to make ends meet. All 7.7 million workers currently receiving the EITC would receive a larger EITC and 5.8 million additional workers would be newly eligible, including 3.3 million under age 25. The increase would lift about half a million people above the poverty line, and reduce the depth of poverty for 10 million more. A worker at the poverty line would receive more than \$600 in additional EITC.

An expanded EITC would encourage work among young adults living independently from their families by helping to establish patterns of behavior that include work. This in turn could lead to more on-the-job experience, more hours of employment and ultimately higher lifetime earnings. An expanded EITC would also harmonize the upper age limit with recent and scheduled increases in the Social Security full retirement age ensuring that older workers continue benefit until they retire.

***Office of Financial Research (OFR)***

**Secretary Lew, we hear a lot of talk in Congress about the need for more transparency. And yet, the inner workings of the Financial Stability and Oversight Council (FSOC) and the Office of Financial Research (OFR) are even more opaque than those of the Federal**

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**Reserve. For instance, OFR is tasked with producing research to help the FSOC make important decisions related to the financial stability of the U.S. economy, but these reports are not made public for interested parties to comment on.**

**Regulatory agencies put their proposals out for comment in order to make sure they have input from all sides. To me, getting as much input as possible seems like a good idea, especially given the type of important financial matters that FSOC and OFR study.**

**Question 34: Do you believe the FSOC and OFR should be more transparent?**

Answer:

The Council and OFR are committed to conducting their business in an open and transparent manner while protecting the confidentiality of supervisory and other market-sensitive information. As part of this commitment, the Council voluntarily adopted a Transparency Policy at its first meeting in October 2010, holds at least two open sessions per year, publishes minutes of each of its meetings, publishes a record of all of its votes, and votes on all proposed and final rules in meetings that are open to the public. For example, the Council voluntarily adopted a rule and guidance regarding its authority to designate nonbank financial companies, after seeking three separate rounds of public comment. Additionally, the Council publishes an annual report that includes a description of all of the Council's prior year activities and its upcoming priorities.

That said, the Council is continually examining how it can balance its responsibility to be transparent with its central mission to identify and monitor emerging threats to U.S. financial stability. At its May 7 meeting, the Council voted to make several changes to its Transparency Policy that, among other improvements, will more quickly provide the public with additional information about the Council's discussions.

In addition, OFR submits to Congress at least two written reports annually and the Director, through Congressional testimony, reports to Congress on the work of the office. In furtherance of OFR's intent to be transparent, the office publishes to its website: 1) the OFR annual report, which includes a description of the office's prior year projects and upcoming agenda; 2) OFR's Human Capital Planning report; and 3) research addressing an array of financial stability issues, via its Working Paper series. Finally, the OFR receives advice from the public through its Financial Research Advisory Committee, which holds public meetings twice a year. The OFR is continuously reviewing ways to maintain an open and transparent business while preserving market-sensitive information.

**Question 35: Would you support opening up OFR studies for public comment generally? If not, why?**

Answer:

With respect to the proposed requirement that reports be subjected to consultation and public comment, this provision would be in significant conflict with the OFR's mandate to provide independent analytic capabilities for the Council. Requiring a comment period for all research,

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even if a different approach would produce a superior research product, would not be appropriate. OFR Working Papers and other academic work are subject to the peer review process that overlays most academic research. The OFR relies heavily on this typical and critical academic process to gather feedback, test theories, and improve models and analysis as it supports the Council through its independent analytic work. A public comment period like that required for rulemakings does not make sense for research. It should be emphasized that OFR reports or research would not result in rulemakings. Moreover, were a primary regulator to rely on an OFR report for any proposed rulemaking, the APA's requirements to engage in notice and comment would apply. For this reason, requiring a public comment period for OFR reports would be unnecessary, duplicative, and could create confusing and unworkable outcomes by creating an administrative record in multiple locations.

**What those of us who have worked in the private sector know acutely is how much business hates uncertainty.**

**Question 36: Given the effect of FSOC's rulemakings, wouldn't more transparency with FSOC and OFR's process help the economy overall?**

**Answer:**

We are proud of the level of transparency the Council has provided to the public and to the firms that are under review. For nonbank financial company designations, the Council has provided considerable public transparency into its process by voluntarily publishing a rule and guidance outlining how it would apply the statutory criteria and review firms for potential designation. In addition, the Council has reported to Congress and released to the public explanations of the basis for each of the three nonbank designations that it has completed.

The Council's rule and guidance on nonbank designations benefited from multiple rounds of public comment, even though the Council was not required to conduct a rulemaking. The public guidance established clear, quantitative metrics that the Council uses to identify firms for evaluation and extensively described the firm-specific analysis that the Council conducts.

Firms under review for potential designation also have numerous and extensive opportunities to engage directly with the Council before any designation. First, early in the process, the Council provides the company with a notice that it is under consideration and an opportunity to submit materials to contest the Council's consideration. This goes beyond the process required under the statute. Second, before any proposed designation, there is extensive interaction between Council staff and the company, including a number of meetings and information requests.

After the Council makes a proposed designation, the Council sends the company a detailed written explanation, including a substantial amount of confidential information, and the firm is entitled to a hearing to contest the proposed designation. For the only firm so far that has requested an oral hearing, the Council granted it, and the Council members themselves presided over the hearing and heard directly from the company's representatives.

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In addition, any designated company has a right to seek judicial review of the designation. The Council also reviews all nonbank designations annually, based on a process set forth in the Council's rule that includes opportunities for subject-company participation.

***Draft 501(c)(4) Regulation – Public Hearings***

**Over 150,000 comments were submitted in response to draft 501(c)(4) regulation.**

**Question 37: Given the overwhelming, if not historical, number of comments on the draft regulation, is the IRS going to hold public hearings on the draft regulation?**

**Question 38: Will the IRS hold more than one hearing and hold them outside of Washington, DC?**

**Question 39: Will you personally commit to allow the public to comment for more than two hours on first-come, first-serve basis in a Washington, DC location?**

**Answers to questions 37 – 39:**

Last November, Treasury and the IRS proposed a new regulation governing political activity of section 501(c)(4) organizations. The proposal generated over 150,000 written comments—the most comments ever received by Treasury and IRS on a proposed tax regulation. As the IRS recently announced, it is likely some changes will be made to the proposed regulation in light of the comments we have received and we have concluded that it would be more efficient and useful to hold a public hearing after publishing the revised proposed regulation. The details of that hearing have not yet been determined. Treasury and the IRS remain committed to a transparent process for providing updated standards for tax-exemption that are fair, clear, and easier to administer.

***RESTORE Act***

**On September 6, 2013, the Department of the Treasury published proposed regulations concerning the investment and use of amounts deposited in the Gulf Coast Restoration Trust Fund. The comment period closed on November 5, 2013.**

**Question 40: When do you expect the regulations to be final?**

**Answer:**

Treasury anticipates publishing an interim final rule and a proposed rule allocating amounts to Louisiana parishes this summer. Both draft rules are currently undergoing the standard process of inter-agency review within the Executive Branch.

**Question 41: How much has been deposited into the Gulf Coast Restoration Trust Fund to date and how much has been expended out of the Gulf Coast Restoration Trust Fund to date?**

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Answer:

Treasury has received two deposits into the Gulf Coast Restoration Trust Fund. The first deposit was received on March 21, 2013, in the amount of \$323,392,876.71. The second deposit was received on March 5, 2014, in the amount of \$329,641,424.66. These funds have been invested in non-marketable Treasury securities. As of May 28, 2014, Treasury has disbursed \$1,060,000.00 to the Gulf Coast Ecosystem Restoration Council for certain programmatic and administrative expenses. The Trust Fund balance as of May 28, 2014, was \$652,233,998.15.

*Primary Standard*

**It has been widely reported that a 501(c)(4) organization satisfies the “primary standard” if 50.01 percent of its activities are for social welfare activities and no more than 49.99 percent of its activities are for political activities.**

**Question 42: Is this in fact the test for satisfying the “primary standard”?**

**Question 43: If so, where in the Code of Federal Regulations, Internal Revenue Manual, or instructions or guidance is this codified? Please provide a copy.**

**Question 44: If not, please submit the written instructions or guidance that IRS employees use for determining whether a 501(c)(4) organization satisfies the “primary standard”.**

Answers to questions 42 – 44:

Although there are existing regulations describing the “primary” standard for determining whether the activities of a tax-exempt entity do indeed promote the social welfare, there is no published Treasury guidance relating to the proportion of an organization’s activities that must promote social welfare for an organization to qualify under section 501(c)(4). In a notice of proposed rulemaking issued last November, the Treasury Department and the IRS invited comments from the public on what proportion of an organization’s activities must promote social welfare for an organization to qualify under section 501(c)(4) and whether additional limits should be imposed on any or all activities that do not further social welfare. The Treasury Department and the IRS also requested comments on how to measure the activities of organizations seeking to qualify as section 501(c)(4) social welfare organizations for these purposes. As noted above, this notice of proposed rulemaking generated over 150,000 written comments—the most comments ever received by Treasury and IRS on a proposed tax regulation. Consistent with our standard practices, we intend to review those comments carefully before taking further steps in the rulemaking process.

*TIGTA and NTA*

**In February, the Commissioner has testified that Treasury Inspector General for Tax Administration (TIGTA) is a valuable partner to the IRS. IG’s don’t create problems, but**

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**help uncover them. Nonetheless, employees are usually reluctant to report problems to either TIGTA or the National Taxpayer Advocate (NTA).**

**Question 45: How often do you meet with the TIGTA or the NTA?**

**Question 46: Do they listen to your concerns? Do they share any of theirs with you?**

**Question 47: If the Secretary is not sharing their concerns with TIGTA and NTA, can employees be expected to bring any of their concerns with them?**

Answers to questions 45 – 47:

The Treasury Department considers its three inspectors general (IGs), including TIGTA, to be valuable partners. Our rules of conduct require Treasury personnel to refer a variety of matters to the appropriate IG, including TIGTA. Once an investigation or audit has begun, our guiding principle is not to interfere in any way while the investigation or audit is pending. We cooperate fully and take appropriate actions to implement IG recommendations. I have told every IG that I have ever worked with, including TIGTA, that he or she has my support and if there are problems, I want to know about the problems and I will take steps to correct them.

The National Taxpayer Advocate is an important independent resource for taxpayers within the IRS and I support her efforts. Former Acting IRS Commissioner Danny Werfel undertook to raise taxpayers' awareness of their rights and tools, such as the National Taxpayer Advocate, and further sought to elevate the transparency of, and accountability for, taxpayer issues raised by the National Taxpayer Advocate. I am confident that Commissioner Koskinen will continue Mr. Werfel's work in this area.

***FinCEN Guidance on Marijuana-Related Businesses***

**In February, both the Financial Crimes Enforcement Network (FinCEN) and the Department of Justice (DOJ) issued guidance to banks providing services to marijuana-related businesses and US Attorneys on marijuana enforcement, respectively. The combination of this guidance should allow both medical and recreational marijuana-related businesses to make full use of banking services and institutions.**

**Question 48: How much more revenue do you expect the IRS to collect as a result of the FinCEN and DOJ guidance?**

Answer:

We have not undertaken a formal analysis of the potential revenue effects associated with the FinCEN and DOJ guidance. In general, regulations and other guidance are intended to interpret statutes, the effects of which are already incorporated in baseline revenue estimates. That said, one effect of regulations allowing marijuana-related businesses to use banking services might be to reduce slightly the underreporting of taxable income by moving transactions from the informal cash-based economy to a more formal banked sector.

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**Question 49: How many “Marijuana Limited” suspicious activities reports have been filed with FinCEN to date?**

Answer:

As of May 12, 2014, FinCEN has received 193 “Marijuana Limited” suspicious activity reports.

**Question 50: Has the Office of Tax Policy considered applying a “sin” tax to marijuana or constructing a regulatory structure around marijuana similar to the regulatory structure around tobacco and alcohol?**

Answer:

Marijuana remains illegal under the Controlled Substances Act. It would be premature at this time to speculate about any potential federal taxation and regulation of marijuana. Any excise tax on marijuana sales would, of course, require legislation.

*myRA*

**By the end of calendar year, Treasury expects to have myRAs up and running. These retirement savings accounts look like a hybrid between Individual Retirement Accounts and Treasury’s Direct Payroll Savings Options.**

**Question 51: How is Treasury going to enforce the income eligibility limitations? (households earning up to \$191,000 a year)**

Answer:

myRAs will be Roth IRAs. myRA account holders will manage eligibility and contribution limits in the same way as other Roth IRAs.

**Question 52: If people exceed the income limitation and make a myRA contribution anyway, will Treasury require them to withdraw the contribution and pay an excise tax similar to how excess contributions to IRAs and Roth IRAs are treated?**

Answer:

myRAs will be Roth IRAs. myRA account holders will manage eligibility and contribution limits in the same way as other Roth IRAs.

**Question 53: How much employee participation does Treasury expect in FY 2015? Do you have a goal?**

Answer:

While reaching uptake goals might be one way of measuring success, it can also be measured in other ways, such as ongoing investment by myRA participants, continued employer support and interest, and encouraging first-time retirement savers to expand their investments for a more secure retirement future.

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Our phased implementation plan will start with a small pool of employers and initial uptake in a manageable range. Further plans will be finalized after we designate a financial agent with experience establishing and maintaining IRA accounts.

**Question 54: How much is Treasury is spending or planning to spend this calendar year on marketing and outreach for myRA?**

**Answer:**

Treasury has a modest budget for outreach and marketing in FY 2014. We have not finalized plans for FY 2015.



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**Questions for the Record Submitted by Congressman Mario Diaz-Balart**

***RESTORE Act***

**Under the RESTORE Act the Department of Treasury was charged with developing the procedures for depositing and expending amounts to and from the trust fund by January 2, 2013 (within 180 days of enactment). These regulations were eventually proposed on September 6, 2013 and subject to a 60 day comment period which ended on November 5, 2013.**

**Question 1: Can you give this Committee an update on the timing of these regulations? Is there an estimated time frame as to when we might expect the final version to be issued?**

**Answer:**

Treasury anticipates publishing an interim final rule and a proposed rule allocating amounts to Louisiana parishes this summer. Both draft rules are currently under review by interested federal agencies.

***Dodd-Frank***

**The Dodd-Frank Act gives Treasury, through the Federal Insurance Office, some limited authority to represent U.S. interests in international insurance regulatory discussions but DFA also makes clear that the states continue to be the primary regulators of insurance and hence the states' policies govern insurance regulation in the U.S. Yet, FIO has taken positions different from and even contrary to, the positions advocated by our state regulators, including the need for a global insurance capital standard that could reduce the relative competitiveness and consumer focus of the U.S. insurance market.**

**Question 2: Does it make sense to interpret DFA to create a potential conflict between the policies of our own regulators here in the U.S. and those advocated by the FIO in international discussions?**

**Answer:**

The Dodd-Frank Act vests Treasury's Federal Insurance Office (FIO) with the responsibility to coordinate federal efforts and develop federal policy on prudential aspects of international insurance matters, including representing the United States at the IAIS. Treasury operates within the authorities bestowed to it by Congress, and we do not believe this role stands in conflict with the states as primary regulators of insurance. International standards will support robust, high quality oversight that will promote global financial stability, promote a level playing field, offer consistent supervisory approaches for regulators around the world, and lead to reduced compliance costs for global firms. FIO coordinates and works closely with state regulators and other federal agencies on international policy matters. U.S. state regulators, individually and through NAIC staff, participate in and often lead international workstreams in which FIO and the Federal Reserve Board (FRB) staff also participate. In fact, all 56 state commissioners and the NAIC are represented in the IAIS, and there is no example of the U.S. representatives agreeing

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to a standard that was contrary to U.S. interests. International insurance supervisory standards have been developed and adopted by the states in the United States for nearly 20 years, and state regulators have been actively involved in the IAIS since its inception in 1994. FIO recognizes that international standards are not self-executing; instead, the standards ultimately will be implemented by the states, exercising their authorities, or by the FRB in certain instances.

**Question 3: Doesn't it make more sense to conclude that while FIO has the authority to engage in representation, the positions it advocates should be consistent with the positions of state officials who, under DFA, have the primary responsibility to regulate insurance in the U.S. and that FIO should focus on getting domestic policy consensus before cutting international deals on new global regulatory standards?**

Answer:

FIO's role is to coordinate federal efforts and develop federal policy on prudential aspects of international insurance matters. In this capacity, FIO coordinates and works closely with state regulators, and relevant federal agencies, and consults with consumers, insurers, and other stakeholders and technical experts. U.S. state regulators, individually and through NAIC staff, participate in and often lead international workstreams related to such standards in which FIO and FRB staff also participate. It is in the best interest of the United States for solvency standards to converge toward international standards and best practices. FIO seeks to work with state regulators and international authorities to shape and influence the substance of these standards. Alignment of national and international solvency standards will facilitate a level playing field at the global level and help protect American citizens. FIO recognizes that international standards are not self-executing; instead, the standards ultimately will be implemented by the states, exercising their authorities, or by the FRB in certain instances.

**Question 4: In connection with the global capital standard discussion, what cost/benefit analysis has Treasury or FIO done to justify the need for a global capital standard for internationally active insurance groups and what analysis has been done to determine its impacts on U.S. companies and consumers?**

Answer:

International standards will support robust, high quality oversight that will promote global financial stability, promote a level playing field, offer consistent supervisory approaches for regulators around the world, and lead to reduced compliance costs for global firms. The FSB called on the IAIS to conduct the qualitative and quantitative work necessary to develop such global capital standards. This work is on-going and informed by FIO, the states and the FRB.

Once the global capital standard is developed, the states, exercising their traditional authorities, or the FRB, will determine whether and how to implement that standard, reflecting the unique nature of the U.S. insurance market and regulatory system. Prior to implementation by the states or the FRB, the concept of the global capital standard will be tested for several years directly with U.S.-based insurers. In addition, an impact analysis will be conducted to determine whether and, if so, how the standard, and related provisions, will affect both individual insurance firms

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and the U.S. insurance market. The testing and the study will allow for the implementation of the international standards to incorporate the best interests of the United States.

**Question 5: If such analyses have been done, when will you provide them to the Committee?**

Answer:

Prior to implementation by the states or the FRB, the concept of the global capital standard will be tested for several years directly with U.S.-based insurers. In addition, an impact analysis will be conducted to determine whether and, if so, how the standard, and related provisions, will affect both individual insurance firms and the U.S. insurance market. The testing and study will allow for the implementation of the international standards to incorporate the best interests of the United States.

*The Financial Stability Board*

**The Financial Stability Board (FSB), in which the U.S. is represented by the Treasury, Fed and SEC, is increasingly issuing directives on insurance regulation to the International Association of Insurance Supervisors that could eventually affect our companies and our state insurance regulators. But, the FSB does much of its work behind closed doors in a manner inconsistent with our own administrative procedures and so far as we know has not conducted any cost benefit analysis on its directives. And, U.S. state insurance regulators, state legislators, and other U.S. stakeholders cannot meaningfully participate, even though they are directly affected by the outcomes.**

**Question 6: What specifically have Treasury officials done to advocate for more transparency in FSB activities, for cost/benefit analyses and to admit U.S. state regulators and legislators to the FSB?**

Answer:

In 2009, in the wake of the largest financial crisis since the Great Depression, G-20 Leaders established the FSB with a broad mandate to promote financial stability and made it responsible for coordinating and monitoring the implementation of their agreed financial regulatory reform agenda. As it carries out its assigned role, the FSB has maintained transparent processes which include maintaining a public website at <http://www.financialstabilityboard.org/> that provides regular detailed updates on its ongoing work and makes publicly available the major documents produced by its committees; publishing a series of consultative documents for public comment; and providing the opportunity for public feedback on major FSB proposals.

For insurance reform, just as the FSB called on the expertise of the banking regulators in the Basel Committee for Banking Supervision for banking reform, the FSB called on the expertise of insurance regulators in the International Association of Insurance Supervisors (IAIS) to develop international insurance standards for global systemically important insurers (G-SIIs) and large, internationally active insurance groups (IAIGs) with the goal of promoting financial stability.

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Treasury's Federal Insurance Office (FIO) coordinates and works closely with state regulators and other federal agencies, and represents the United States at IAIS. International insurance supervisory standards have been developed and adopted in the United States for nearly 20 years. U.S. state regulators, individually and through NAIC staff, participate in and often lead international workstreams in which FIO and the Federal Reserve Board (FRB) staff also participate. International standards will support robust, high quality oversight that will promote global financial stability, promote a level playing field, offer consistent supervisory approaches for regulators around the world, and lead to reduced compliance costs for global firms. Once developed, these standards are not self-executing but will be implemented in the United States by the FRB or the states, and will be tailored to support the U.S. insurance marketplace.

**The Financial Stability Board (FSB), in which the U.S. is represented by Treasury, the Fed and SEC, is increasingly engaged in insurance regulatory matters and has issued directives to the International Association of Insurance Supervisors to come up with global capital standards for insurers, with the apparent agreement of the Treasury.**

**Question 7: What data and other empirical evidence did the Treasury and FSB rely upon to determine that global capital standards are necessary for the insurance sector and benefit consumers more than our current system?**

Answer:

Once the global capital standard is developed, the states, exercising their traditional authorities, or the FRB, will determine whether and how to implement that standard, reflecting the unique nature of the U.S. insurance market and regulatory system. Prior to implementation by the states or the FRB, the concept of the global capital standard will be tested for several years directly with U.S.-based insurers. In addition, an impact analysis will be conducted to determine whether and, if so, how the standard, and related provisions, will affect both individual insurance firms and the U.S. insurance market. The testing and the study will allow for the implementation of the international standards to incorporate the best interests of the United States.

**Question 8: What cost benefit analysis was done before the directive was issued by the FSB? Can you provide that information?**

**Question 9: When will you provide it?**

Answer to questions 8 and 9:

Once the global capital standard is developed, the states, exercising their traditional authorities, or the FRB, will determine whether and how to implement that standard, reflecting the unique nature of the U.S. insurance market and regulatory system. Prior to implementation by the states or the FRB, the concept of the global capital standard will be tested for several years directly with U.S.-based insurers. In addition, an impact analysis will be conducted to determine whether and, if so, how the standard, and related provisions, will affect both individual insurance firms and the U.S. insurance market. The testing and the study will allow for the implementation of

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the international standards to incorporate the best interests of the United States.

***Money Market Mutual Fund Reform***

The Securities and Exchange Commission has been working on finalizing a proposal on money market mutual fund reform. The proposal includes the option to require institutional prime money market funds to change the pricing from a stable net asset value (\$1 in equal \$1 out) to a floating net asset value. Now, the fluctuations in value are very, very miniscule because the nature of the underlying fund securities (including U.S. Treasuries) are short-term and very safe.

A major obstacle to making the floating NAV work for money market funds is the tax complication it would create for investors, particularly large corporate investors that use money market funds as a cash management tool and constantly move money in and out of these funds throughout the day. Ultimately, it would create very miniscule capital gains/losses for investors. And while the IRS has already proposed relief on wash sale rule, it doesn't address the issue when the buy/sale occurs outside the wash sale parameters. SEC Chair Mary Jo White recently indicated that SEC staff has been working with the IRS staff on addressing the tax issue.

**Question 10:** Can you describe where you are in the process in fixing this issue with the SEC?

Answer:

The Treasury Department (including the IRS) has been exploring these issues ever since it became known that new regulatory requirements being considered for money market funds might implicate tax compliance issues. Last summer, the SEC proposed new money market fund regulations, and a few weeks later, IRS proposed *de minimis* relief from the wash sale rules. Public comment on this proposed relief and on the SEC proposals, however, requested additional simplification. If the SEC adopts the floating NAV in its final regulations, we expect that we will, as appropriate, issue guidance for taxpayers in a timely fashion.

**Question 11:** Can you make all of the necessary changes using your administrative power or do you need a legislative change?

Answer:

The Treasury Department and the IRS have been considering guidance to provide additional simplification within our current administrative power. However, we are always happy to work with Members on legislative provisions that would improve the administration and functioning of the Tax Code.

**Question 12:** Will the potential changes be transparent to the public and subject to notice and comment?

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**Question 13: Is it subject to cost-benefit analysis?**

**Answers to questions 12 and 13:**

While it would be premature to comment specifically on the form of hypothetical guidance that has not been issued, as a general matter, when the guidance takes the form of regulations, we invariably provide notice and seek comment. In addition, in this case, we issued a notice in the Internal Revenue Bulletin containing a draft revenue procedure providing wash sale relief on which we sought comments. Those comments are being considered in preparing any final guidance. This notice-and-comment process helps ensure that guidance issued is fair and minimally burdensome. We always strive to reduce burden, and with simplification as the primary goal, we expect any guidance in this area to actually reduce overall burden.

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